S. HRG. 100-356

FARM CREDIT CAPITAL CORPORATION TESTIMONY OF THE BOARD OF DIRECTORS AND CHIEF EXECUTIVE OFFICER

HEARING

BEFORE THE

SUBCOMMITTEE ON AGRICULTURAL CREDIT

OF THE

COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY UNITED STATES SENATE

ONE HUNDREDTH CONGRESS

FIRST SESSION

ON

ALLOWING THE BOARD MEMBERS AND THE PRESIDENT OF THE FARM CREDIT SYSTEM CAPITAL CORPORATION TESTIMONY ON FARM CREDIT SYSTEM LEGISLATION

JUNE 9, 1987

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FARM CREDIT CAPITAL CORPORATION TESTIMONY OF THE BOARD OF DIRECTORS AND CHIEF EXECUTIVE OFFICER

TUESDAY, JUNE 9, 1987

U.S. SENATE,
SUBCOMMITTEE ON AGRICULTURAL CREDIT OF THE
COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY,
Washington, DC.

The subcommittee met, pursuant to notice, at 2:35 p.m., in room SR-332, Russell Senate Office Building, Hon. David L. Boren (chairman of the subcommittee) presiding.

Present or submitting a statement: Senators Boren, Boschwitz, Cochran, Karnes, and Helms.

Also present: Senator Lugar.

OPENING STATEMENT OF HON. DAVID L. BOREN, A U.S. SENATOR FROM OKLAHOMA

Senator BOREN. We'll call the hearing to order. I want to thank our guests from the Capital Corporation who have come here to testify today. Of course, trying to fashion a means of dealing with the crisis that we have in the entire Farm Credit System, I think all of us realize that the survival of the System is of key importance to the agricultural community, to the farmers of this Nation, to the general economy of the agricultural States, and to the agricultural producing sector.

We also realize that we are dealing with a problem that is not getting any better. We continue to lose about $1 billion a month in terms of loan volume lost from borrowers leaving the System. And oftentimes these are the borrowers who are most able to afford to repay those loans. So in some ways we are losing the strongest borrowers out of the System, leaving the System even weaker and the need for action is very, very strong. The subcommittee will begin very soon on the markup of legislation to deal with this problem.

The purpose of today's hearing is to allow the board members and the president of the Farm Credit System Capital Corporation an opportunity to have their voice heard as we begin drafting Farm Credit System legislation.

I want to welcome all the members of the board and Mr. Macklin, the president of the Capital Corporation.

As I am sure you are all aware, most of the bills that have been introduced will be on the spreadsheets of the committee as we begin the markup would totally eliminate the Capital Corporation. It is unclear in most of those bills what entity would assume the

tasks that the Capital Corporation presently has. Given the large number of nonaccruing loans in so many districts, it would appear that there is a clear need for providing local associations and districts some type of technical assistance. I am not sure whether the best course is to remove all nonaccruing loans from the local associations and districts and placing them in an entity like the Capital Corporation or whether the Capital Corporation should merely be involved in the business of restructuring loans.

One of the difficulties we have had in the past is the failure on the part of most districts to address their problems and to attempt to restructure as many loans as possible. There seems to have been an unwillingness to write-down principal even if it were actually better over the long term to do so. We have seen situations where that has been true in local boards where perhaps some members whose own loans have not been written down are hesitant to write-down other people's loans. And yet that would have the effect in the long run of being financially beneficial as well as beneficial to the stabilization of land values. I understand that in many circumstances even the local boards and district boards have not wanted to write-down principal because of the belief that unless everyone gets principal written down, no one should. This has been a part of the problem that we have faced with some associations in dealing with the problem at hand.

As one who is most often affiliated with the concept of local control, in which I strongly believe, I also understand the need to have some objectivity with respect to reviewing problem loans. Oftentimes, it is difficult to get that objectivity at the local level in certain circumstances. Perhaps that is a role the Capital Corporation can effectively play, perhaps not.

I, personally, do not want us to merely be creating additional bureaucratic entities to handle problem loans. It is my hope that the legislation we report out of the subcommittee will provide an effective, objective manner of handling problem loans and will ensure that as many loans as possible will be restructured so that farmers can remain on the farm.

I welcome the members of the board and Mr. Macklin and look forward to hearing your comments as to how we might best achieve a balanced legislative proposal.

We have several members of the board with us this afternoon. Mr. John St. John, the chairman of the board of directors, Farm Credit System Capital Corporation from Orlando, Florida; Mr. Howell Hughes, a member of the board of directors, Farm Credit System Capital Corporation, from Springfield, Massachusetts; Mr. Leo Allmendinger, board member from Selby, South Dakota. We are glad to have you with us. Mr. Mark Wilkinson, board member of the Capital Corporation from Summit, New Jersey; Mr. Francis Ferguson, who of course is vice chairman, from Milwaukee, Wisconsin. I have had the privilege of dealing with him before in the Finance Committee on other matters. It is a pleasure to have you with us this afternoon.

Mr. FERGUSON. Thank you.

Senator BOREN. And Mr. Macklin, the president and CEO of the Farm Credit System Capital Corporation. We are very glad to have all of you with us.

Without objection the prepared statement of Senator Helms will appear in the record.

[The prepared statement of Senator Helms follows:]

PREPARED STATEMENT OF SENATOR JESSE HELMS, AGRICULTURE SUBCOMMITTEE ON AGRICULTURAL CREDIT, JUNE 9, 1987

Senator HELMS. Mr. Chairman, thank you for this opportunity to discuss the farm credit problems facing the agricultural sector.

In the spring of 1986, the Governor of North Carolina, the Honorable James G. Martin, called together a meeting of the "farm family"—composed of farm organizations, commodity groups, North Carolina State University Agriculture Extension Service, and the North Carolina Department of Agriculture to discuss ways to improve the farm economy. From this meeting Governor Martin appointed the "Task Force on the Farm Economy." This task force brought together, for the first time, representatives of the three farm-lending sources in North Carolina—the Farm Credit System, Farmers Home Administration, and private banks.

The Governor's task force made the following recommendations to strengthen the Farm Credit System. I would like these proposals made part of the record and I hope they will be used constructively in putting together farm credit legislation.

PROPOSALS BY THE GOVERNOR'S TASK FORCE ON THE FARM ECONOMY TO STRENGTHEN THE FARM CREDIT SYSTEM

1. Congress, through the Farm Credit System administration, must make the changes necessary to immediately bring interest rates down.

2. Insure that stronger districts are not crippled and destroyed by "shoring up" weaker districts, i.e. stop the flow of funds between districts.

3. Management practices must be reviewed. The Farm Credit System must be run more efficiently and become competitive with commercial banks. Administration should also examine personnel policy. Employees need to be properly trained and sympathetic to farmers' needs.

4. Protect present borrowers' stock and present savers' savings accounts.

5. Create a secondary market for mortgages held by the Federal Land Bank. Selling mortgages would increase the availability of agricultural credit. Would be similar to present "Fannie Mae" loans used for housing.

It is apparent that in order to carry out the above changes, an infusion of federal dollars will be necessary. Funds should be in the form of a loan, similar to the loan made to establish the Farm Credit System. Immediate steps should be taken to accomplish this.

Senator BOREN. I would say that Senator Karnes was among those that suggested this hearing. And he may wish to make some opening comments. Also we have been joined by the ranking member of the subcommittee, Senator Boschwitz. Senator Daschle is kindly standing in for me over on the floor right now, managing the bill that is pending there. He will be coming over in a few minutes to join us and has expressed a very strong interest in this subject, as have other members of the subcommittee.

Senator Boschwitz, are there any comments that you might like to make before we hear from the panel?

Senator BOSCHWITZ. No, Mr. Chairman. It seems to me I saw some of this testimony over the weekend. Is this the same panel that appeared in the House?

Mr. FERGUSON. I was not here.

Senator BOSCHWITZ. It was my feeling as I looked at the testimony, very frankly, Mr. Chairman, I presume that some of the Farm Credit System is paying to have them all here, as I looked at the testimony I thought that one or two people could do it just as well. But perhaps I am mistaken.

Senator BOREN. Well, I think, Senator Boschwitz, that most of the members of this board are very, very busy people and I think

they all have a perspective and an expertise to contribute. They are in essence volunteer citizens, involved as citizens in this. So I think it is useful to have them come. And I appreciate their willingness to do so.

Senator Karnes, you may have opening comments that you would like to make before we hear from the panel.

STATEMENT OF HON. DAVID K. KARNES, A U.S. SENATOR FROM NEBRASKA

Senator KARNES. Thank you, Mr. Chairman.

I very much appreciate you responding to my request for this hearing. I also thank the members of the Capital Corporation board for appearing today. I believe they can provide us with some useful information and insights.

I requested that the subcommittee call this hearing for several reasons. There are a number of legislative proposals before us. Some have urged the Capital Corporation be abolished. However, we must answer several related questions before we take action in this regard.

First and foremost, should the Capital Corporation be eliminated? If not, how can we supplement the powers of the Capital Corporation to assure its success? If we should do away with the Capital Corporation, what functions of the Capital Corporation should be continued? And who should continue to service those functions?

Second, Congress is being asked to provide billions of dollars in financial assistance to the Farm Credit System. I do not believe and I do not think other Members of the Senate—nor do I think that other members of this subcommittee believe that all of the System's problems are due simply to economic factors. Let's face it, in certain districts the Farm Credit System has had management problems, and that has lead to losses totaling literally in the hundreds of millions of dollars.

Do we know the extent that management problems have produced these financial problems? Should we be willing to make billions of dollars of assistance from the taxpayers available to the System at this point in time? The losses are being borne by the conservative farmers who have run their operations soundly over the years. This Congress cannot put taxpayers money into the System until we are assured that the causes of the problems have been corrected. We cannot allow the money of good farmers and taxpayers to be placed at risk.

Third, we must approach the topic of restructuring prudently and with a great deal of thought. We must be realistic. Loan restructuring is done with the money of the successful and responsible farmer borrowers of the System who are not in trouble.

We must ask several related questions. How many loans can and should be restructured systemwide? What are the consequences if restructurings are too liberal? Where is the competence in the System to do the restructuring? Is the necessary management expertise in place? We need answers to these questions before any more farmer or taxpayer money is spent on restructurings.

Finally, we must look at the opportunities that these circumstances present. There are proposals to create a secondary market

system in agricultural mortgages. I strongly favor that approach. I believe it is time that we made the same access to the capital markets which is enjoyed in the housing sector available to agricultural lenders for the benefit of all farmers.

We must have a secondary market which is not dominated by any one group of lenders and which will assure competitive lending to agriculture. It would be useful to get the views of many of our witnesses today to comment on the secondary market aspects that some of them may be familiar with. They may have experience in looking at, for example, the Fannie Mae and the Freddie Mac process. I would like to know what their thoughts are in the role of the secondary market.

Indeed, I just spoke at noon to the Fannie Mae Advisory Committee. That group of 35 professionals from all across this country, including representatives of Wall Street, were very responsive to the thought of having a secondary market in agricultural mortgage loans. They have agreed, as they testified on the House side, that is, Fannie Mae has agreed to provide whatever technical assistance available to legislators, to make sure that the secondary market mechanism that we are contemplating is one that indeed works and will be effective and viable.

Mr. Chairman, I believe we have an opportunity to get answers to the type of questions that I pose today and the many others that this subcommittee has asked. I thank you for calling this hearing and look forward to asking some of these questions more specifically as we proceed, and I look forward to the comments of our distinguished speakers and panelists today. I appreciate very much their coming and making their very valuable time available to the subcommittee. Thank you very much.

Senator BOREN. Thank you very much, Senator Karnes.

I think what we will do, Mr. Macklin, is just to proceed. Perhaps you can suggest an order in which those that are here would like to speak.

If any of you brought any individual statements or a group statement, we will receive the statement in full for the record. I think it would be best, rather than reading the entire statement, to read parts of the statements that emphasize particular points you want to make. If you could, summarize the highlights for us.

We would value your thoughts not only on the future of the Capital Corporation itself and what role it might play, but also your thoughts about reform of the System in general, questions about centralization, the way in which loans should be made, among what appraised values should they be made, and other items that we can certainly benefit from the expertise of those gathered together in terms of the policy questions that we will be facing.

So I will turn it over to you. I think what we will try to do is allow all of the group to speak before we interrupt with asking questions. Then we can just direct questions to members of the panel in general.

Mr. MACKLIN. Thank you very much, Mr. Chairman. With your permission we would like to start with Chairman John St. John.

STATEMENT OF JOHN ST. JOHN, CHAIRMAN OF THE BOARD OF DIRECTORS, FARM CREDIT SYSTEM CAPITAL CORPORATION, SENIOR VICE PRESIDENT OF PLANNING, CITRUS CENTRAL, INC., ORLANDO, FL

Mr. ST. JOHN. Thank you very much, Mr. Chairman.

Mr. Chairman, and distinguished members of the subcommittee, in order to make the best use of your limited time, we will keep our formal comments very brief and try to focus directly on the Capital Corporation.

Mr. Chairman, we have submitted more extensive written testimony to the subcommittee, and we respectfully request that this written testimony be made a part of the record.

Senator BOREN. Without objection that will be done.

Mr. ST. JOHN. Thank you, sir.

The Farm Credit Amendments Act of 1985 created a new institute, the Farm Credit System Capital Corporation to provide financial and technical assistance to those Farm Credit institutions which were experiencing financial difficulties.

The Corporation was to provide this assistance by redistributing the financial resources of the System to assist those that were having financial difficulties by acquiring nonperforming assets from System institutions and holding, restructuring, collecting, and administering those nonperforming assets by providing technical and other assistance to troubled System institutions, and by receiving and administering to troubled System institutions any financial aid which might originate from outside the System.

Today, almost 2 years later, the System continues to face problems which threaten its ability to provide reliable, affordable credit to its borrowers. We are here this afternoon to explore the role that the Capital Corporation has had, and will continue to have, in solutions to those problems.

I have asked Mr. Macklin and each of my fellow board members to provide their views on this subject. And we will start I believe with Mr. Howell Hughes.

STATEMENT OF HOWELL HUGHES, MEMBER OF THE BOARD OF DIRECTORS, FARM CREDIT SYSTEM CAPITAL CORPORATION, SPRINGFIELD, MA

Mr. HUGHES. Mr. Chairman, distinguished members of the subcommittee, my name is Howell Hughes. I am the recently retired CEO of the Farm Credit Banks of Springfield.

A component of the Farm Credit Amendments Act of 1985 called for the use of System self-help whereby financially stronger system institutions would contribute funds to assist their weaker counterparts through the Capital Corporation. Contributing institutions believe the Corporation would serve to minimize the amount of financial assistance provided by providing a business oriented oversight role upon recipient institutions.

The Corporation has done this through agreements which authorize it to monitor, to oversee, and in certain cases, approve actions of recipient institutions.

The majority of the System's institutions are viable. But they do not have a practical way to protect their interests in troubled insti-

tutions as guarantors of the System debt obligations or as providers of assistance except through the oversight functions performed by the Capital Corporation. In the event of Federal assistance to the System, the functions performed by the Capital Corporation will be of interest to the general public, since they too will need assurance that their investment in the System is being properly applied to the problems.

From these points of view the Capital Corporation, or someone else, to perform the oversight role is needed. This was recognized in the 1985 act which was and still is a good piece of legislation that simply needs a chance to work.

Thank you, Mr. Chairman.

STATEMENT OF LEO ALLMENDINGER, MEMBER OF THE BOARD OF DIRECTORS, FARM CREDIT SYSTEM CAPITAL CORPORATION, SELBY, SD

Mr. ALLMENDINGER. Mr. Chairman and members of the subcommittee, I am Leo Allmendinger. I own and operate a wheat and small grain farm near Selby, South Dakota. I have been a land bank and production credit association borrower-member almost all of my farming career.

I have served on the board of the Federal Intermediate Credit Bank of Omaha which received $100 million of financial assistance from the Capital Corporation. The Corporation also purchased non-performing loans of $140 million from the related Production Credit Association of the Midlands.

This assistance was administered in a very responsive and a very effective manner. Without it these institutions would not have been able to continue to extend credit to their borrowers. The Corporation has carried out a similar program of assistance for the FICB and PCA's, in the Spokane district.

My experience has been, that given adequate funding, the Corporation can and will structure effective assistance packages for troubled banks and associations. Thank you very much, Mr. Chairman.

Senator BOREN. Mr. Wilkinson.

STATEMENT OF MARK WILKINSON, MEMBER OF THE BOARD OF DIRECTORS, FARM CREDIT SYSTEM CAPITAL CORPORATION, SUMMIT, NJ

Mr. WILKINSON. Mr. Chairman and distinguished members of the subcommittee, my name is Mark Wilkinson. I am one of two publicly appointed directors of the Capital Corporation. I recently retired as senior vice president of the Prudential Agricultural Group. Most of my 40-year lending career was spent dealing one on one with farmers.

The Capital Corporation was created to separate the handling of troubled loans from servicing the good business. I have seen this same approach effectively employed by the Prudential in the handling of troubled loans.

I share with you the concern that the System's troubled borrowers be shown fair and compassionate treatment by the Farm Credit System and the Capital Corporation. The troubled borrower has special servicing needs. This borrower needs patient understanding,

close consideration of his operation, his financial position, and his workout alternatives.

I am also concerned, however, over the treatment received by the approximately 600,000 borrowers who keep current on their debt obligations. When the attention of the loan origination servicing staff is focused on troubled accounts, the quantity of service devoted to the good borrowers can and often does suffer. And I believe this has happened in parts of the System. In their effort to work out troubled loans, some System institutions have failed to give the customer, who is making his payments and keeping his loans current, prompt, courteous, and attentive service.

The Capital Corporation has helped to address this problem. Those districts where we are active, the banks and associations are able to focus upon the good customers in the ongoing business while our staff of specialists, through special asset groups, work exclusively with troubled accounts.

Workout or special assets groups, as they are sometimes called, have a number of advantages. They maximize the use of skilled and experienced workout officers who are in short supply. Workout groups provide an objective individual to replace the original loan officer who sometimes has his own judgment at stake when a loan goes bad.

Workout groups can improve the servicing of troubled accounts due to specialization. Lessons learned and tools developed can be used in repetitive situations and in other regions.

The Capital Corporation has used these advantages. The resulting workout efforts are beginning to produce encouraging results, as Mr. Macklin will discuss with you.

Thank you, Mr. Chairman.

Senator BOREN. Thank you very much, Mr. Wilkinson.

Mr. Ferguson.

STATEMENT OF FRANCIS FERGUSON, VICE CHAIRMAN OF THE BOARD OF DIRECTORS, FARM CREDIT SYSTEM CAPITAL CORPORATION, MILWAUKEE, WI

Mr. FERGUSON. Senator Boren and distinguished members of the subcommittee, my name is Francis Ferguson. I am vice chairman of the Capital Corporation and retired chairman of the board of Northwestern Mutual Life Insurance Company of Milwaukee, Wisconsin.

Since 1985, when the Capital Corporation was created by Congress, significant time and resources have been committed to organize, staff, and startup its operations. The Corporation's board of directors have established and operated the Corporation in full compliance with the letter, spirit, and intent of the Farm Credit Amendments Act of 1985. We are proud of the staff that we have assembled and also the accomplishments to date.

The Corporation has demonstrated its ability to carefully restructure and work out troubled loans, to manage or liquidate acquired properties. It is my judgment that this entirely separate organization is the best way to address many of the problems of the System.

Concentration of accountability for troubled accounts in acquired property will realize operational and many other efficiencies. It

will reduce the amount of Government support which may be needed by the System. And I don't think we can emphasize it too much it also will free the 12 banks and their staff who perform their most important service, as Mark mentioned earlier, and that is servicing the good borrowers. And they are by far in the majority.

If the Capital Corporation is eliminated, it must be replaced by some other entity with like responsibilities and capabilities. Elimination and subsequent replacement will merely lose more precious time in properly addressing the System's problems in a forthright and responsible manner.

Mr. Chairman, I believe the worst possible solution for the System's problems would be to permit it to continue business as usual. All concerned and interested parties should and will demand much more than that. The System should be preserved and strengthened and to me there is no question that it must operate in a much more efficient and businesslike manner.

Capital Corporation or an entity like it has a singularly important, short-term role to play in helping the System to achieve its long-term objectives.

Thank you.

Senator BOREN. Thank you. Mr. Macklin.

STATEMENT OF HUGH R. MACKLIN, PRESIDENT AND CHIEF EXECUTIVE OFFICER, FARM CREDIT SYSTEM CAPITAL CORPORATION, KANSAS CITY, MO

Mr. MACKLIN. Mr. Chairman and distinguished members of the subcommittee, my name is Hugh Macklin. I am the president of the Farm Credit System Capital Corporation and I would like to speak about what this Corporation has not accomplished and what it has.

One of the Corporation's functions is to administer System self-help. The Corporation in September 1986 called upon financially stronger System institutions to purchase the Corporation's stock to provide funds to assist those experiencing financial problems. Many of the strong System institutions citing deficiencies in the underlying regulation refused to honor this call. Others honored the subscription but subsequently sued the Capital Corporation to refund the money they contributed, resulting in legal actions that paralyzed the Corporation's capacity to raise funds for troubled institutions thus limiting its ability to administer self-help effectively.

Another of the Capital Corporation's functions is the management of the nonperforming assets. It provides this service for Federal land banks in five districts and production credit associations in two districts through the use of special assets groups.

The Capital Corporation manages $2.8 billion of nonperforming assets. As of April 30, 1987, these assets consisted of over 17,000 loans which were the System's most troubled loans, and nearly 3,000 acquired properties.

During the first 4 months of 1987, the Capital Corporation worked out settlements on 5,846 loans, or about 31 percent of the accounts that have been assigned to us. Of those accounts, 50 per-

cent resulted in the loan being paid current or paid in full. In 1,774 cases, the Capital Corporation either compromised, reamortized, or took some other action to reconstruct the account.

Of this group, only 585 of the actions taken, or approximately 10 percent of the total settlements, resulted in foreclosure actions. Foreclosure, which involves the most human suffering, is the most costly way to resolve a troubled account and is initiated only as a last resort.

In addition to those foreclosed properties, I must say we had approximately the same number that were settled through bankruptcy, but were restructured and are in our account. Those borrowers who can be successfully restructured, and even those who show any reasonable hope for recovery are restructured.

The Corporation is also committing itself to allow family farmers to work through their problems if there is any possible hope. The Corporation's efforts to sell acquired property have also been successful. During the first 4 months of this year the Capital Corporation sold 593 properties totaling $138 million or about 20 percent of the number presently held. Sales of another 197,000 acres for $87 million were pending at the end of April.

The Farm Credit System needs to take strong action to work through its nonperforming assets in a logical, businesslike, and compassionate manner. Its financial problems will not be resolved until it does. This will be difficult, but necessary if the System is to make effective use of its own resource and minimize the amount of outside assistance it may need.

Over the last 14 months the Capital Corporation has recruited and built a staff of credit and financial professionals who are dedicated to working toward this end. It will take them or someone like them, knowledgeable, experienced, and not afraid to undertake a difficult and sometimes very unpopular action to get the job done.

Thank you very much for this opportunity. We will be very happy to entertain any questions the subcommittee may have.

[The prepared statement of board of directors and chief executive officer follows:]

FARM CREDIT SYSTEM CAPITAL CORPORATION

Testimony of Board of Directors

and Chief Executive Officer

Before the Subcommittee on

Agricultural Credit

Committee on Agriculture, Nutrition
and Forestry

U. S. Senate

June 9, 1987

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Testimony by John St. John
Chairman of the Board of Directors
Farm Credit System Capital Corporation

Before the Subcommittee on Agricultural Credit

Committee on Agriculture, Nutrition and Forestry

U. S. Senate

June 9, 1987

Mr. Chairman and Distinguished Members of the Subcommittee:

My name is John St. John. I am Chairman of the Board of Directors of the Farm Credit System Capital Corporation, which has its headquarters in Kansas City, Missouri. I am Sr. Vice President of Planning with Citrus Central, an Orlando, Florida based cooperative. I also serve as a member of the Board of Directors of the Federal Farm Credit System Funding Corporation, and I have served on the Boards of the Farm Credit Banks of Columbia and of the Central Bank for Cooperatives.

With me today are the other members of the Capital Corporation Board. Our Vice Chairman, Mr. Francis Ferguson, is the retired Chairman and Chief Executive Officer of Northwestern Mutual Life Insurance Company of Milwaukee, Wisconsin. Mr. Leo Allmendinger is a grain farmer from Selby, South Dakota who has served on the Boards of the Farm Credit Banks of Omaha and of a Federal Land Bank Association in that District. Mr. Mark Wilkinson is a retired senior executive of the Prudential Agricultural Group of Newark, New Jersey. Mr. Howell Hughes is the recently retired Chief Executive Officer of the Farm Credit Banks of Springfield.

Two members of the Capital Corporation's senior management are also with us today. Our Chief Executive Officer is Mr. Hugh Macklin, who has a distinguished 40 year career in agricultural finance. Mr. Tom Brown is our Executive Vice President in charge of field operations. Mr. Brown's career in agricultural finance includes experience as CEO of two agricultural community banks in Minnesota, and lengthy service with institutions of the Farm Credit System.

The Capital Corporation's Board and management are very pleased to respond to the Subcommittee's request to report to its members regarding the operations and effectiveness of the Corporation. To make the best use of our limited time, we would like to keep our formal comments very brief and focused directly on the Capital Corporation. To that end, we would like not to get into such general areas as the overall state of agriculture, the condition of the Farm Credit System, or discussion of the many ideas and plans that have been proposed as solutions to these problems. Rather, we would prefer to focus sharply on the Capital Corporation - its short history, its present status and our thoughts about its future.

In the summer of 1985 the Farm Credit System found itself in extremely serious circumstances:

- o The System had just experienced the largest loss in its 70 year history.
- o Loan volume was decreasing at an alarming rate and the quality of its remaining portfolio was deteriorating rapidly.
- o The value of the farm land which represented the basic collateral for its loans had dropped precipitously and showed no signs of leveling off.

I won't go through the entire litany of the problems because I know the members of the Subcommittee have them all too well in mind.

At that time, this Subcommittee, together with System leaders and your colleagues in the Congress, expended a great deal of time and effort in examining these problems and seeking a long-range solution to them. These efforts culminated in the passage of the Farm Credit Amendments Act of 1985, which was signed into law on December 23 of that year.

The cornerstone of that legislation was the creation of a new entity - the Farm Credit System Capital Corporation - which was charged with the mission of carrying out a program of financial and technical assistance to those Farm Credit institutions which were experiencing financial difficulties.

The Corporation was to provide this assistance by:

- o Redistributing the financial resources of the System to assist those experiencing financial difficulty.
- o Acquiring nonperforming assets from System institutions and holding, restructuring, collecting, and administering them.
- o Providing technical and other assistance to troubled System institutions.
- o Receiving and administering to troubled System institutions any financial aid which might originate outside of the System.

Today, almost two years later, the System finds itself facing even greater problems. We are here specifically to explore the role that the Capital Corporation has had and might continue to have in solutions to those problems.

With respect to the Capital Corporation, we feel that there are two fundamental questions which must be addressed:

1. Is there still a need for some entity to perform the functions assigned to the Corporation by the 1985 Amendments, and, if so

2. Is the Capital Corporation as presently structured still the most effective vehicle for carrying out these functions?

Each of my fellow Board members will provide their responses to these questions, after which our CEO will provide his views. We will then listen carefully to your questions and provide our considered and candid responses.

Thank you, Mr. Chairman.

Testimony by Howell Hughes
Member of the Board of Directors
Farm Credit System Capital Corporation

Before the Subcommittee on Agricultural Credit

Committee on Agriculture, Nutrition and Forestry

U. S. Senate

June 9, 1987

Mr. Chairman and Distinguished Members of the Subcommittee:

My name is Howell Hughes. I am a newly elected member of the Board of Directors of the Farm Credit System Capital Corporation. For the past 38 years I have served in various capacities with Farm Credit institutions in the Springfield District, recently retiring as Chief Executive Officer of the Farm Credit Banks of Springfield. I was CEO of the Springfield Banks for twelve years.

I would like to make the following four points in my testimony:

1. All farmer-borrower members are directly affected by the events affecting their financial cooperative. There is no way to insulate them or their cooperatives from the events.

2. The Capital Corporation is doing a good job of fulfilling its mission as described in the 1985 Farm Credit Amendments.

3. A majority of the Farm Credit Banks are viable; but they sorely need a disciplinarian to protect their interests, since they are jointly and severally liable on all Farm Credit System debt. The Capital Corporation is the only vehicle available for that purpose.

4. It is the objective of the Capital Corporation to restructure every troubled loan which has any economic promise for the farmer-borrower. However, since loan restructuring represents forgiveness of principal or interest, costs are incurred. Some past, present or future borrower-member will have to pay the amount forgiven.

A unique feature of the Farm Credit System is that each of its institutions is an agricultural financial cooperative. There is no way to insulate the System's borrower-owners or their cooperatives from the hazards of factors outside of their control. The events that have occurred in agricultural economics during the 80's have been very complex and of unprecedented proportions. Almost all of them have had negative impacts. Earned surpluses, reserves for losses, regulatory accounting practices or even government assistance to the System may shift the timing of the consequences of

recent and continuing economic events. However, the ultimate impact of these events cannot be avoided, only deferred.

All financial institutions are highly leveraged. They make large use of other people's money. In recognition of this, each financial industry has a disciplinarian...a regulator. The 1985 Farm Credit Amendments Act transformed the System's regulator, the Farm Credit Administration, from a considerate, patron regulator into an independent, arms-length regulator with new and tougher enforcement tools. Remember, please, that the new FCA has been in place for only 18 months. Its Board and staff are still in the process of learning and implementing a new role.

The 1985 Amendments formalized the Capital Corporation as a tool to aid troubled banks in the management of nonperforming loans and by the provision of financial assistance. The Capital Corporation has been functioning in its present role and form for a little more than a year. From where I sit, I believe the Corporation has done a good job under some very difficult circumstances. It is now prepared to do more even better.

The majority of the System's institutions are viable, but they have no practical way of protecting their interests as guarantors of all System debt obligations or as providers of assistance to troubled System institutions except through the functions performed by the Capital Corporation. At the very least, the involvement of the Capital Corporation with troubled institutions avoids disincentives to good management performance and business results in the viable System institutions.

In the event of Federal assistance to the System, the functions performed by the Capital Corporation will be of interest to the general public, since they too will need assurance that their investment in the System is being properly applied to the problems.

In brief, I believe the Capital Corporation is needed. If I were the "decision maker" I would give the 1985 Amendments a chance to work. It was, and still is, a good piece of legislation.

I would like to comment briefly on a very important and sensitive subject...loan restructuring. The Capital Corporation's policy is a matter of record. Each and every troubled account in which the Corporation is involved is to be given full consideration for restructuring. Restructuring is done if there is any chance that it will work for the borrower and that the cost of the restructuring, that must be borne by his fellow cooperative members, will be the same as or less than other alternative actions.

Despite the fact that the Capital Corporation must deal with the System's most troubled accounts, the restructuring record thus far is encouraging. Mr. Macklin will be providing information during his presentation.

No person or institution can be perfect in dealing with a problem of this magnitude which has such an impact on the lives and livelihood of so many people. Neither the Capital Corporation nor any other agricultural lender or manager of nonperforming agricultural loans can live up to everyone's expectations regarding loan restructuring.

Unfortunately, there are a number of accounts where restructuring is simply not going to be in the best mutual interests of the borrower and his fellow cooperative members. The greatest irony would be realized by all parties involved when a restructured borrower fails the second time. Then, not only will all of the borrower's financial burden be transferred to his neighbors and fellow cooperative owners, he also will have lost a few more years of his life in economic frustration.

I want to reiterate that the Capital Corporation has been restructuring and will continue to restructure every troubled account where that makes any sense at all for the borrower and his fellow cooperative members. The benefit of any reasonable chance simply must be given, especially to troubled family farm operations.

Thank you, Mr. Chairman.

Testimony by Mr. Leo Allmendinger
Member of the Board of Directors
Farm Credit System Capital Corporation

Before the Subcommittee on Agricultural Credit

Committee on Agriculture, Nutrition and Forestry

U. S. Senate

June 9, 1987

Mr. Chairman and Distinguished Members of the Subcommittee:

My name is Leo Allmendinger. I own and operate a wheat and small grain farm near Selby, South Dakota. I am a member of the Board of Directors of the Capital Corporation. For many years, I served on the Board of the Farm Credit Banks of Omaha and of a Federal Land Bank Association in that District. I have been a Land Bank and Production Credit Association borrower-member almost all of my farming career.

During part of my tenure on the Capital Corporation Board I also served on the Boards of two Banks which are receiving assistance from and have entered into management agreements with the Corporation. These are the Federal Land Bank and Federal Intermediate Credit Bank of Omaha.

Through the Corporation, 34 other System Banks provided direct financial assistance of $100 million to the Federal Intermediate Credit Bank, and about $140 million in nonperforming loans were purchased from the related Production Credit Association of the Midlands. The Corporation is continuing to workout the purchased nonperforming loans, including restructuring where feasible. In my opinion, this assistance, provided through and by the Capital Corporation, has been administered in a very professional and effective manner. This assistance program was instrumental in avoiding significant problems for the FICB and PCA, without which these institutions may not have been able to continue operations. The Corporation has carried out a similar program of assistance for the FICB and PCAs in the Spokane District with the same effective results.

In the case of the Omaha Land Bank, assistance was requested from the Capital Corporation in the third quarter of 1985. The Corporation and the Omaha Land Bank have entered into an agreement which provides that the Bank, pursuant to regulations, may use regulatory accounting practices for its provision for losses and certain of its interest expense. The agreement also provides that the Corporation will manage and service certain of the Bank's nonperforming assets and its acquired properties under contract. In my opinion, these agreements and arrangements have been working fairly well. The Corporation has entered into agreements of this nature with three other Land Banks, and it has entered into other kinds of agreements of either a permanent or an interim nature

with four other Land Banks. These also have been reasonably successful, in my opinion.

The point I want to make, from my perspective as a Board member of both receiving institutions and of the Capital Corporation, is that the Corporation's Board and management have exerted their best possible efforts to implement the intent of Congress as expressed in the Farm Credit Amendments Act of 1985.

Thank you, Mr. Chairman.

Testimony by Mark Wilkinson
Member of the Board of Directors
Farm Credit System Capital Corporation

Before the Subcommittee on Agricultural Credit

Committee on Agriculture, Nutrition and Forestry

U. S. Senate

June 9, 1987

Mr. Chairman and distinguished members of the Subcommittee:

My name is Mark Wilkinson. I am one of two publicly appointed directors of the Capital Corporation. I recently retired as Senior Vice President of the Prudential Agricultural Group, a major real estate lender to agriculture. My lending career spans over 40 years. Most of my experience was dealing - one on one - with farmers. I accepted a position on the board of the Capital Corporation because I thought I could help the farmers who need financing and are in trouble.

Congress, in the 1985 Act, created an entity to separate the handling of troubled loans from servicing the good business. This concept, which has worked so successfully in other lending institutions, was implemented through the Capital Corporation. After personally experiencing the effectiveness of the Prudential's handling of troubled loans using this technique, I firmly favored this approach.

The Farm Credit System, in my estimation, is experiencing trouble servicing its borrowers. This applies to both its good borrowers and its troubled accounts.

I know well the problems of the System's troubled borrowers. I share with you the concern that they be shown fair and compassionate treatment by the Farm Credit System and the Capital Corporation. The troubled farmer has special servicing needs that must be recognized and met. The troubled borrower needs patient understanding and time consuming consideration of his operation, his financial position, and his workout alternatives. Oftentimes the farmer needs advice concerning his alternatives and their ramifications. Debt relief can be a taxable event and limited guidance can help the borrower identify the associated pitfalls, causing him to seek competent advice to avoid them.

I am also concerned, however, over the treatment received by the approximately 600,000 borrowers who keep current on their debt obligations. I know some good system borrowers who have not received an acceptable level of service. The customer who is making his payments and keeping his loan current deserves prompt, courteous and attentive service.

When the attention of the loan origination and servicing staff is focused upon troubled accounts, which require large amounts of time, attention and manpower, the quality of service devoted to the good borrower can, and often does suffer. I believe this has happened in parts of the System. In their efforts to workout troubled loans some System institutions have lost sight of the needs of their paying customers.

I believe the Capital Corporation has helped to address this problem. In those districts where we are active, the Banks and Associations are able to focus upon the good customers and the ongoing business while our staff of specialists works exclusively with troubled accounts. The division of duties helps insure that each group can be attentive to the needs of their respective borrowers, whether they are troubled farmers or successful borrowers.

Workout or Special Assets Groups, as they are sometimes called, have a number of advantages. Because of the special requirements, working troubled loans requires a staff with a special blend of talent and experience. "People skills" are a necessity as are maturity, good judgement and an even temper. The workout officer also must have a solid knowledge of agricultural finance. Since candidates meeting all these criteria are in short supply, and troubled farm loans are not, these people are best employed closely supervising groups of less versatile, skilled and experienced staff. In this manner their experience and judgement can be more widely applied. The workout group is the best vehicle for doing this.

Specialized workout groups avoid problems that inevitably occur between loan officers and troubled borrowers. The loan officer who originated the credit has much at stake when a borrower becomes unable to honor the terms and conditions of the loan agreement. The originating officer has his judgement and reputation at risk. Once trouble develops, the loan officer and farmer often find themselves at cross purposes. Workout groups provide an objective third party to resolve the obligation in the best interests of both the borrower and the bank.

Workout groups can improve the servicing of troubled accounts due to specialization. Lessons learned in one area can often be successfully adopted in other regions. New techniques or tools can be quickly employed in other similar situations. Repetitive problems can be addressed with repetitive solutions as the organization learns what will work and what will not. The benefits of this specialization can allow an organization to reduce the commitment of resources to handling troubled accounts and to increase the effectiveness of a given number of staff.

The Capital Corporation's performance as a specialized workout group, I believe, has utilized many of these advantages. The resulting effects of the workout efforts are beginning to produce encouraging results, as Mr. Macklin will discuss.

Thank you, Mr. Chairman.

Testimony by Francis Ferguson
Vice Chairman of the Board of Directors
Farm Credit System Capital Corporation

Before the Subcommittee on Agricultural Credit

Committee on Agriculture, Nutrition and Forestry

U. S. Senate

June 9, 1987

Mr. Chairman and Distinguished Members of the Subcommittee:

My name is Francis Ferguson. I am the Vice Chairman of the Board of Directors of the Capital Corporation and one of two public members on that Board. I retired as Chairman of the Northwestern Mutual Life Insurance Company of Milwaukee, Wisconsin in January 1985. I was with Northwestern for 34 years. My early career included credit and appraisal work with Farm Credit institutions in the St. Paul District, and lengthy service in the Farm Mortgage Lending Division of Northwestern Mutual. I became President and CEO of Northwestern in 1968.

Over the last twenty years I have served on ten "Fortune 500" Company Boards and I now serve on the Boards of Ralston Purina, Singer, Continental Illinois Corporation and Nortwestern Mutual plus three private companies or trusts. I own and operate a grain farm in central Nebraska.

Agriculture in general and the Farm Credit System in particular are faced with a very complex set of problems. These problems cannot be solved by a "quick fix," or even by a simplified set of solutions.

The ultimate solution to these problems is controlled by market economics. However, a large segment of America's agricultural producers will require at least five years, if not as much as ten, to adjust to a market economy. Well thought out programs will be required to appropriately ease the burden of transition for selected classes of producers. This will be a most important consideration in refining public agricultural policy in the months and years ahead. But, these programs must be sensible in terms of their costs relative to their objectives and results, and of their impact on the Federal budget.

I would now like to speak directly to the problems of the Farm Credit System and the role of the Capital Corporation in helping to solve them.

I'd like to begin with the Farm Credit Administration, the System's "regulator." There is no doubt in my mind that the lack of a firm and independant regulator in years past contributed in no small way to the depth of the System's current problems. FCA's new role as an independant, arm's-length regulator of the System

must be clarified and strengthened. It should be free from political pressures - patterned after other agencies responsible for regulating other financial industries, such as the FDIC, the Fed, or the Comptroller of the Currency.

The Capital Corporation already had a significant responsibility assigned to it in March of 1986 when I was first appointed to its Board. Since that time, the Corporation has made great strides in building a professional staff and organization. This staff now has the ability to carefully and humanely restructure and/or work-out nonperforming loans and to efficiently manage and/or liquidate acquired properties. If the Capital Corporation is eliminated, with which I very much disagree, it must be replaced by some other entity with like responsibiliies and capabilities. Efficiency of operation and economy of solution dictate that such an entity, whatever it is, must have a certain degree of independance from the balance of the System.

There has never been a financial institution that has been successful in a workout situation that hasn't established a totally separate group to manage and service the nonperforming assets. Experience has shown that the people or organizations which made the original loans have had significant problems working out tough situations which they created. I would like to share three examples of this with which I am very familiar.

First, the Continental Illinois Corporation, parent of the Continental Illinois Bank. I serve on Continental's Board as a new Director to help bring that institution back to a position of respectibility and profitability. A workout section was established to relieve the regular organization of those duties so it could continue to service the regular customers. Without such a workout section all staff and management would soon become entangled in the problem accounts, putting out fires, trying to sell properties and working out solutions to problem accounts only to see the regular operation of the bank placed in a self-liquidating mode. The same problem holds true for the Farm Credit System and the same solution is applicable.

Second, the experience of the life insurance industry during and after the depression years of the 30s. The Connecticut Mutual Life of Hartford, Connecticut established a complete and total workout group at least five years before the rest of the industry followed suit. We all lived with Connecticut Mutual's resulting competitive edge for a good many years. Conn Mutual, after forming their workout group, then proceeded to rebuild their mortgage loan department by making many good loans with little competition from the rest of the industry.

Third, Nothwestern Mutual was one of the latecomers to realize the benefits of a workout group. This was established just before World War II. All sections of the mortgage department were in a liquidating mode prior to the establishment of the workout group. They found they had little or no time to properly service remaining good accounts or to seek and make good, new loans. This

literally changed overnight with the establishment of the Special Real Estate Division, which was Northwestern's name for their workout group.

In each of these cases, reporting requirements and accountabilities for the workout groups bypassed all levels of the organization and went directly to the CEO. Because of the extreme severity of the nonperforming asset and other problems in the Farm Credit System, it is my judgment that an entirely separate organization is better able to work out the problem loans and acquired property.

Even though "local control" is an important issue for the System in the long run, concentration of the management and servicing of troubled accounts and acquired property over some minimum size will realize operational and other efficiencies, thus reducing the amount of Government support needed by the System.

This approach also will permit the Boards and managements of System institutions to concentrate their efforts on the making and servicing of good loans in a cost efficient and effective manner. They will then have the time and resources, free of concern about workout problems, to focus carefully and deliberately on operational and other improvements required to further minimize the amount of Government assistance needed and the time required to pay it back. These same efforts will be key contributers to the return of troubled System institutions to competitiveness, profitability and viability.

Mr. Chairman, I believe the worst possible solution for the System's problems would be to permit it to continue business as usual. All concerned and interested parties should and will demand much more than that. The System should be preserved and strengthened, but it must operate in a much more efficient and business-like manner. I also believe the Capital Corporation has a singularly important short-run role to play in helping the System to achieve its longer-term objectives.

Thank you, Mr. Chairman.

Testimony by Hugh R. Macklin
President and Chief Executive Officer
Farm Credit System Capital Corporation

Before the Subcommittee on Agricultural Credit

Committee on Agriculture, Nutrition and Forestry

U. S. Senate

June 9, 1987

Mr. Chairman and Distinguished Members of the Subcommittee:

My name is Hugh Macklin. I am the President of the Farm Credit System Capital Corporation.

The Capital Corporation was created by the Congress in the Farm Credit Amendments Act of 1985. It was chartered on February 24, 1986. Significant time and resources were required to organize, staff, and to start up operations of the Corporation. In March 1986, the Farm Credit Administration issued regulations governing the Corporation's activities and powers. The newly constituted Board of Directors was seated in April. I joined the operation in August, and initiated a stock subscription to capitalize its operations. Throughout the fall and winter the Corporation's staff prepared and executed first-time agreements with troubled System banks under which the Corporation began to provide technical assistance, oversight, or management of nonperforming assets as called for in the 1985 Amendments. Operations began in earnest early this year.

The Board of Directors and management have endeavored to establish and operate the Corporation in full compliance with the letter, spirit and intent of the 1985 Amendments. In doing so -- in executing the provisions of the law the Farm Credit System had proposed -- the Corporation has had to take some unpopular positions and actions. We accept that as part of the job.

I'd like to speak about what the Corporation has accomplished, and what it hasn't. I'll focus on three areas of our operations. First, the Corporation performs oversight activities of the operations of those System banks that need assistance. Second, the Corporation funds its operations and provides the "System self-help" prescribed by the 1985 Amendments, by calling upon financially stronger Banks and Associations for funds to help it do so. Last, the Capital Corporation manages much of the System's nonperforming loans and handles the disposal of acquired property.

I'll talk first about our oversight role. An integral component of the 1985 Amendments called for the use of "System self-help" whereby financially stronger System institutions would contribute funds to assist their weaker counterparts through the Capital Corporation. This approach created two classes of institutions; contributors to financial assistance and recipients of assistance.

Each group has its own views of the Capital Corporation. The contributing institutions believe the Corporation must minimize the amount of financial assistance required. To do so it must take a tough-minded approach with recipient institutions by providing close oversight and prohibiting the types of management and fiscal practices which contributed to their problems. The Corporation has done this through a series of agreements which confer to it the authority to monitor, oversee, and in certain cases, disapprove actions of recipient institutions. The Capital Corporation, we believe, performs this role well.

Some recipients of financial help view this oversight role as both intrusive and redundant of the function performed by the Farm Credit Administration. FCA, however, reviews financial and operational results only after the fact. We review business decisions and goals on an ongoing basis. The two functions are independent and do not conflict.

The Corporation's second function is to administer the System "self-help" designed into the 1985 Amendments. To fund the assistance needs of distressed System institutions and to help fund its operating expenses, the Corporation, in September 1986, called upon financially stronger System institutions to purchase the Corporation's stock. Though made in accordance with regulations prescribed by the Farm Credit Administration, many of the strongest System institutions, citing deficiencies in the underlying regulations, refused to fund this call. Others honored the subscription but, for similar reasons, subsequently sued the Capital Corporation to refund the money they contributed. Resulting legal actions have paralyzed the Corporation's capacity to raise funds within the Farm Credit System. The necessary legal efforts to collect these funds have adversely affected the Corporation's relations with many of the financially stronger banks and associations.

The inability of the Corporation to effectively raise funds has crippled its capacity to assist those System institutions in financial need and has cast doubts on its ability to administer self-help effectively.

The Capital Corporation's third function is the management of nonperforming assets. It provides this service for Federal Land Banks in five districts and the Production Credit Associations in two districts. Nonperforming assets consist of nonaccrual loans, loans in the process of foreclosure, and acquired property.

To do this the Capital Corporation has established a "Special Asset Group" within each of the five Farm Credit Districts. Headed by Capital Corporation employees, these are groups of specialized professionals familiar with the techniques and approaches necessary for handling troubled loans. Special Asset Groups have proven to be an effective tool for other lenders with troubled loan portfolios. They are established outside the financial institution's traditional lending hierarchy to allow the autonomy and flexibility necessary to restructure or collect distressed

loans. Special Asset Groups separate the management of ongoing business from the administration of troubled loans and allow the managers of the ongoing business to focus on meeting the credit needs of good, new and existing borrowers.

Despite the success of special asset management groups in other institutions, System Banks had made no use of them until the Capital Corporation first established them in Districts where it manages troubled assets under contract. In fact, three Districts where troubled loans are a problem, and the Capital Corporation has no involvement, are now only beginning to develop these teams. The delay in establishing special asset groups demonstrates, we believe, an unwillingness to face the very difficult tasks of loan workout, restructure, and collection in a businesslike manner. It represents an effort to postpone rather than tackle these problems.

Though objective performance standards for loan workout groups are difficult to establish, we are very pleased with our performance for the year to date. Through its Special Assets Groups the Capital Corporation manages $2.8 billion of nonperforming assets. As of April 30, 1987, these assets consisted of over seventeen thousand loans totaling $2.4 billion and nearly three thousand acquired properties, amounting to 1.3 million acres which are worth $439 million.

During the first four months of 1987, the Capital Corporation worked out settlements on 5,846 loans, or about 31 percent of the accounts that have been assigned to us. Forty percent of these settlements resulted in the loan being paid current. Another ten percent were accounts paid in full. In 1,774 cases, the Capital Corporation either compromised, reamortized or took some other action to restructure the accounts. It is important to note that the borrowers in all of these cases stayed on the farm after the accounts were settled.

Only 585 of the actions taken, or 10 percent of the total settlements, resulted in foreclosure actions. Foreclosure is the most costly way to resolve a troubled account and is initiated only as a last resort.

The Corporation's efforts to sell acquired property have also been successful. During the first four months of this year we sold 593 properties, which is about 20 percent of the number presently held. The sales covered 350 thousand acres for $138 million. Sales of another 197 thousand acres for $87 million were pending at the end of April.

Despite this success, the efforts of the Capital Corporation and its Special Asset Groups have had detractors. Some maintain that the Corporation's collection efforts ignore the needs of less fortunate System borrowers and leave a perception of mistreatment by the Farm Credit system.

We don't agree. We think the Capital Corporation's loan workout staff is the best qualified in the Farm Credit System. Our professionals have an overriding commitment to agriculture. Their backgrounds, upbringing, and education are based on the best traditions of this country's agricultural sector. Our top management and Board of Directors (as shown in the biographical sketches contained in Exhibit I) also reflect a depth of knowledge and experience in agriculture and agricultural lending. All our people are committed to the future of the Farm Credit System and the success of its borrower-owners.

This knowledge of agriculture and background experience is applied with sensitivity when managing troubled loans. Those borrowers who can be successfully restructured, and even those who show any reasonable hope for recovery, are restructured. The Corporation is also committing itself to allowing small farmers the time necessary to work through their problems. The capacity to do this on a large scale, however, is beyond the resources of troubled institutions. We feel a workable plan can be developed, given adequate funding, to give troubled, small farmers the ability to delay principal and interest payments.

The Farm Credit System needs to take strong action to assure its survival and continued ability to provide competitively priced credit to agriculture. Its financial problems will not be resolved until the System can work through its nonperforming assets in a logical, businesslike and humane fashion. The System needs to provide the disciplined, business-oriented management necessary to work out its operational problems and to see that weaknesses are corrected.

These changes will be difficult, but necessary, if the System is to make effective use of its own resources and minimize the amount of outside assistance it may need. The changes will not happen by inertia. The System has not yet demonstrated the willingness to face these tasks on its own. Someone will have to make these changes occur.

Over the last 14 months, the Corporation has recruited and built a staff of credit and financial professionals who are dedicated to bringing about these changes. The Board and management of the Farm Credit System Capital Corporation believe it will take them or someone like them - knowledgeable, experienced and not afraid to undertake the difficult and sometimes unpopular actions - to get these jobs done.

We believe the approximately 600,000 System borrowers who pay their loans deserve the assurance that their future borrowing costs are not going to be raised by continuation of poor business practices nor reluctance to address the nonperforming assets.

Thank you very much for this opportunity. We would be happy to entertain any questions the Subcommittee might have.

Exhibit I

FARM CREDIT SYSTEM CAPITAL CORPORATION

Background Information on Members of
the Board of Directors, Senior Management
and Administrative Management

May 28, 1987

Members of the Board:

Mr. John St. John, Chairman of the Board, is the Senior Vice President - Planning for Citrus Central, Inc., an Orlando, Florida cooperative which fabricates containers for processed citrus products. He has served as a financial and operations manager in the citrus and beverage industries for many years, mostly with cooperative institutions in the Southeast. He has had long service as a Director of the Farm Credit Banks of Columbia and of the Central Bank for Cooperatives in Denver, Colorado. He currently is a Director of the Federal Farm Credit Banks Funding Corporation headquartered in New York City, and he serves on the Board of American Pioneer Telephone Company. Mr. St. John also does consulting work with citrus industry cooperatives.

Mr. Francis E. Ferguson, Vice Chairman of the Board, was Chairman and Chief Executive Officer of Northwestern Mutual Life Insurance Company until he retired in February 1985. He continues to serve as a Trustee of Northwestern Mutual. Mr. Ferguson joined Northwestern in 1951. Early in his career he did appraisal and credit work with Farm Credit institutions in the St. Paul District. Mr. Ferguson serves as a Board member for the Continental Illinois Bank of Chicago, the Ralston Purina Company of St. Louis, Missouri and several other major firms and private trusts and foundations. He owns and operates a grain farm in central Nebraska.

Mr. J. Mark Wilkinson, member of the Board, recently retired as Senior Vice President after a life-long career with the Prudential Agricultural Group of Newark, New Jersey. Mr. Wilkinson also serves on the Board of Okeelanta Corporation, a sugar cane producer in Palm Beach, Florida.

Mr. Leo A. Allmendinger, member of the Board, is a full time farmer. He owns and operates Allmendinger Farms, Inc., of Selby, South Dakota, which produces wheat and other small grains. He is the former Chairman of the Board of the Farm Credit Banks of Omaha, and he has long service with that Board and with the Board of a Federal Land Bank Association in the Omaha District.

Mr. Howell Hughes, member of the Board, recently retired as Chief Executive Officer of the Farm Credit Banks of Springfield. Mr. Hughes has over 38 years of experience in serving the credit needs of agriculture in the Northeast. He is a former Chairman of the Board of the Federal Farm Credit Banks Funding Corporation and a former Chairman of the Farm Credit System Finance Subcommittee.

Senior Management:

Mr. Hugh R. Macklin, President and Chief Executive Officer, joined the Corporation in August 1986. His career in agriculture and agricultural finance spans 40 years. It includes extensive experience in long-term farm financing and managing agricultural operations in several Western states. He retired as a senior agricultural lending executive of Northwestern Mutual Life Insurance Company several years ago and then successfully engaged in several undertakings in agriculture of an entrepreneurial nature.

Mr. Thomas E. Brown, Executive Vice President and head of the Field Division, joined the Corporation in November of 1986. Prior to this he was employed by First Bank System of Minneapolis, Minnesota as CEO and Director of two agricultural community banks in Minnesota. Mr. Brown served for two years as Senior Vice President of the Farm Credit Banks of Spokane and for eight years as the President of the Montana Livestock Production Credit Association.

Mr. William A. BeSore, Senior Vice President and Chief Financial Officer and head of the Finance and Administration Division, joined the Corporation in October of 1986. He has 18 years of Farm Credit Service beginning with 11 years with the Federal Land Bank of Omaha, 5 years with the Farm Credit Banks of St. Louis and a year with the Farm Credit Corporation of America in Denver, all in various management capacities in the areas of finance, accounting, administration and data processing. He worked for several years in the insurance, energy and manufacturing industries before beginning his Farm Credit service in 1969.

Mr. Glenn L. Stevens, Senior Vice President and head of the Operations and Management Review Division, joined the Corporation in February of 1987. He began his 16 years of Farm Credit service with the Farm Credit Banks of Baltimore in 1971. He was Senior Vice President of Operations when he left the Baltimore Banks in March of 1986 to purchase an interest in and to become President of Neuhaus'es, Inc., of Glenn Rock, Pennsylvania, a farm equipment dealership. After successfully revitalizing this business, he sold his interest in it back to other shareholders to accept the opportunity to join the Capital Corporation's senior management team.

Administrative Management:

Mr. Richard T. Needham, Vice President and Controller, joined the Corporation in January 1987. He spent three years with the Farm Credit Administration at McLean, Virginia in various financial and operational management capacities. He was with the Farm Credit Banks of Baltimore for two and one-half years as Assistant Vice President and Controller. He spent four years with a savings and loan association in Baltimore, Maryland as Controller and three years with a public accounting firm, also in Baltimore. He is a CPA and holds masters degrees in finance and taxation.

Mr. Thomas W. Hill, Vice President - Financial and Operations Analysis, joined the Corporation in January 1987. Prior to this he had been with the Farm Credit Banks of Spokane for 12 years in various financial and accounting management capacities. Key positions held were Treasurer of the Federal Intermediate Credit Bank and Vice President of Association Financial Services for joint District operations. He was with a public accounting firm in Texas for a year and one-half prior to joining the Farm Credit Banks of Spokane.

Mr. Alan J. Misler, Vice President and Corporate Counsel and Corporate Secretary, joined the Corporation in March 1987. He received his Juris Doctor degree from the University of Baltimore. He began his 11 years of Farm Credit service with the Baltimore District as a staff attorney and was later promoted to Assistant General Counsel. He joined the Federal Intermediate Credit Bank of Jackson as Vice President and General Counsel in April 1983. On merger of the management and staffs of the Farm Credit Banks of Jackson he became Vice President and Deputy General Counsel for the combined operation.

Senator BOREN. Thank you very much, Mr. Macklin, and we thank all of you.

What we will do now is proceed in taking rounds of questioning until members have had a chance to ask all the questions they would like to ask.

Let me begin the process. Mr. Macklin, if the Capital Corporation had received more funds during this period of time, during the past year, do you think you could have accomplished more? How much more do you think you could have accomplished?

Mr. MACKLIN. Yes, sir, I feel that we would have been a long way down the road from where we are right today. We have really struggled to function without funds. We have worked in a management capacity. If we had been able to have funds to buy some of these System assets, I think we could have done a more effective and more humane job of settling these accounts.

Senator BOREN. So a part of the problem is not being able to get underway as quickly as you would have liked to have been able to move. Was the shortage of funds being tied up by the lawsuits? Was the problem that the assessments were not paid in as originally anticipated?

Mr. MACKLIN. Yes, sir, that was a major factor.

Senator BOREN. Do you think it is important then that whatever we do, if we were to keep a Capital Corporation structure of some kind or some entity performing this function, that we would clear up, we would combine some statutory language with some kind of a fixed assessment program that would clarify once and for all this problem and resolve it?

Mr. MACKLIN. Yes, sir, that has been a hinderance to performing what we felt was our role. But, in addition, that has been extremely expensive.

Senator BOREN. What percentage of the nonaccruing loans in the System do you believe could be restructured in some manager as opposed to forcing this into a liquidation mode?

Mr. MACKLIN. In the strictest sense, sir, when we receive these loans they have been worked for some time. We do not get a fresh loan.

Senator BOREN. Surely.

Mr. MACKLIN. It is delinquent. In many, many cases these people are insolvent. Without suffering some losses and strictly sticking to the policies that we have, if you get into 15 or 20 percent on a very strict basis, you have about reached the end of the restructuring. If there was a way to handle some of those losses through outside sources, that figure would change.

Senator BOREN. Let me ask, Mr. Wilkinson, you talked about the workout groups that have been put together and have operated very effectively. I think Mr. Ferguson also talked about the fact that if we did not have the Capital Corporation we would need some entity that would perform this kind of function.

In some districts informal workout groups have been put together that work in conjunction with the local association with the Capital Corporation. Is that right?

Mr. WILKINSON. I believe that is correct, sir.

Senator BOREN. And how would you see all of this working? One of the problems that I run into is a feeling that the Capital Corpo-

ration is an entity that is more or less removed, that there is some feeling at some time that if they foreclose, that somehow, some far-off group that has no feeling for the local people who they are foreclosing made the decision.

Yet, on the other hand, we know we have problems sometimes with local associations being hesitant to restructure a loan or write-down principal because you have board members sitting right there and others who undoubtedly will have their principals written down. It is understandable that they would have this human feeling.

Is there any way we could combine this kind of operation, come up with some sort of a plan under which the Capital Corporation perhaps could ultimately be in charge of the restructuring, that we would not have any foreclosures by local associations unless by an informal group? I could foresee, for example, having a sort of voluntary group, a workout group, to come up with a plan for restructuring as opposed to a foreclosure.

They would have to look at it, let us say if the local association were going to recommend foreclosure, and then have that workout more or less handled by the Capital Corporation, if it were agreed to at the local association. Perhaps have the local association do the foreclosing if you had to actually go to a foreclosure so those involved would not feel it was some far-off group that was involved in making the final decision on the foreclosure.

Is there any way we can keep the positive aspects of the Capital Corporation and maintain some balance here, with an external objective look, and at the same time not leave the farmer with a feeling that this far-off group with which they have really no contact is the one deciding to foreclose upon them? Is there a possibility of working out, as you see it, a kind of add-on to this that would involve some sort of informal workout group or a workout group that did not have, let us say, final power to make the decision, but could be utilized to come up with recommendations?

Mr. WILKINSON. Well, I would hope, Senator, that we can have a workout group. And as I say, where I come from is working one on one to get next to and get with that local farmer and that local association.

Senator BOREN. Are those people from a district workout group?

Mr. WILKINSON. Well, I would like them to come from the local district. I think in most cases that is what we have done. The bulk of the staff comes from those local associations and local districts.

We have one or two key people being responsible for, overseeing, and looking after that group and telescoping decisions on back a little further, back to the corporate office to where our man, Tom Brown, or Mr. Macklin or somebody, can help guide and make sure that things are judged from an independent perspective and objectively.

It has been my experience that a loan I made I really felt obligated to protect that loan if it got into trouble, because I thought I had my own reputation on the line. I think if you can get a bona fide group of local people who are in touch with the farmer and can help him review all of his own alternatives and review his financial situation he then can get some help and some guidance all the way back to the senior officers of the Capital Corporation

would be my idea of how that should work. I think we are kind of working, gradually getting to that point.

Senator BOREN. So that group is really working out of the Capital Corporation, utilizing the people in the local area or local district, to come up with this plan, a workout plan. Now, once they come up with a recommendation, some of them I suppose have to recommend that you just have to foreclose. There is no other alternative. Some of them will come out with various forms of restructuring or workout arrangements, some partial deed-backs combined with saving some of it and so on, all sorts of variations.

Does that then go back to the local board for a decision as to whether or not to accept that plan? Or how does that work?

Mr. WILKINSON. I believe it is—these fellows may correct me—but I think we are currently working that way now, we eventually make that final decision. One thing I think you have to keep in mind in working with troubled borrowers and talking about us as a system. There frequently are many other creditors who play a key role in whatever the workout you eventually can accomplish.

Senator KARNES. Am I correct in assuming that all of you believe that the Capital Corporation is something which should be retained and is doing a good job? Would the answer to that be uniformly yes?

Mr. MACKLIN. Yes, sir.

Senator KARNES. What additional powers, if any, would you like to see provided to the Capital Corporation in order for it to do its job better? We have heard a little bit about whether if additional funds or more funds would have been made available, you could have done your job better. Are there other things that you would have liked to have seen—tools that should have been provided or could have been provided—that would have allowed you to do your job better?

Mr. MACKLIN. Senator Karnes, one of the things that we either did not have or have lost along the way was very specific responsibilities and authorities. In our agreements with the various banks we have provided financial assistance. In return they have signed an agreement. In all honesty that agreement has given us quite wide authorities, some that we probably should not have. In the sense of trying to complete the agreement, we have taken what authority was necessary to complete that transaction.

But I think it is very important that the role of the Capital Corporation be defined in a rather narrow way to provide monitoring of management of the bank itself at best, but not day-to-day involvement beyond that management. And that has been a little bit of a weakness, and to some degree, a problem in our relationships, because it was not specifically spelled out. There has sometimes been that disagreement.

Howell, may I ask you to respond to that question also?

Mr. HUGHES. Well, I have been in the System for a very long while—for the last 12 years as a president—and one of the things that becomes apparent to you is that the banks do not have a good mechanism to manage the contingent liability that is represented by their joint and several liability on the bonds.

The tools that are available within the System institutions themselves are very macro in nature. One of the tools which probably

should not be used is shutting off an individual bank from the money market. It is an available tool, but it is so severe in nature, that it probably should not be used except as a last resort.

Therefore, I look for someone to give the banks a method of determining whether other banks are getting into trouble. In other words, some kind of reading, if you will, prior to severe difficulty. And that is potentially a function of the Capital Corporation. This is especially necessary since the FCA has become more like a regulator of commercial banks—an "arm's length" regulator.

So this, Senator Karnes, is the one possibility of putting in legislation that is a particular function to the Capital Corporation.

Senator KARNES. So, in other words, what you are saying is that Congress provided them, the System itself, with certain powers, but it may be more of a blunt instrument than a scalpel. We may need something more precise to deal with the problem.

Mr. HUGHES. Yes.

Senator KARNES. This leads me to another question. Do you gentlemen feel that we have adequately identified the scope of the problems at the banks that have created the situations that you try to address at the Capital Corporation? Do you think we have an understanding of the management problems at the banks? You gentlemen are, in my opinion, in a unique position to see the good and the bad of the management structure and the operations of the institutions themselves. Do you feel we have covered the waterfront as far as identifying the problems that have lead to your "call to force," so to speak, to deal with problem assets?

Mr. MACKLIN. Yes, sir, we have acted as a common denominator, something that has not existed within the System and should be able to identify the problems. That perhaps is an early warning system to some of the problems. But I am not sure that we have identified all of those problems.

Perhaps Mr. Ferguson has some ideas about that.

Mr. FERGUSON. I have got a few. I think one of the things we should keep in mind, and this reply is not directly to your question at the moment.

When I was first approached to be on this board I looked at the legislation that had been created in 1985 and my first response to Treasury was—who were the ones who asked me originally if I would consider this assignment—yes, I would under one circumstance. I could foresee obvious contentions arising because of the responsibilities and the place in which the Capital Corporation was put.

There is no way that this organization or any other kind of organization can be anything but a black hand. I mean you just have to recognize it. We are a son of a gun as far as the borrower is concerned. The association does not like us if we go in there and suggest to look over their shoulder and say that they are not doing a very good job at this. The banks do not like us for the same reason.

There is no way that we can even approach wearing a white hat. I think we have to recognize that it takes a special kind of a guy in a workout situation—or a girl—to have the stomach—these are nasty darn jobs to do. And the nastier they are—I mean the better you know the borrower, the nastier they become.

If you are his neighbor, you know, this is a terrible thing to boot somebody off his farm that has been there for the third or fourth generation, and especially if you have been great friends of his. It is one of the problems the System has in the local control sort of thing.

I am not suggesting you do away with it. But it is inherent in local control that you are going to have some of these problems. If you do away with us—and God knows I do not need this job. In fact, I wonder—continually my wife asks me why did you take it?

You know, somebody is going to have to assume that role. I think that the real consideration of all of this is the guys who are sitting there paying their bills, have not gotten themselves into difficulty—you know, you can always say, well, these guys borrowed themselves into great trouble and all of the rest of it. We were all pretty optimistic about agriculture a few years ago. In fact, I even bought a farm during that period.

We have to be concerned about having some objectivity to protect those 5, 600,000 farmers who are there paying their bills and will continue to. The quickest thing that we can do to drive away another billion every month is to not have a reasonably objective approach to the restructuring or closing if you have to, doing all sorts of reshaping of the loans. Forgiving interest, forgiving principal are not the only ways to do it.

I think there is not a person at this end of the table that would suggest that the guy who is on the farm today who got himself in trouble has probably got the best possibility of getting himself out of it if it is possible to get out of it at all.

Sometimes the most humane thing is also the most economical thing. I do not know if that is responsive to your——

Senator BOREN. Mr. Ferguson, while you are talking, let me ask if you were sitting here as a member of this subcommittee and were thinking about making reforms down the line. I know you have talked in the past about independent, the need for truly independent regulatory work. We have things to consider. Over the years we have inched up on the appraisal values. We have gone from really appraising on relatively low percentage of agricultural value up to a much higher percentage of market value of the land and that sort of thing.

What are some of the basic reforms that if you could sit down tomorrow and write this bill the way you would want to write it without any considerations other than just what is written, what would make this System work without any political considerations or anything else? I might ask all of you to comment on this to some degree. What would you do?

Mr. FERGUSON. Well, I think the first thing I would do is to take a look at the governance of the System. I do not know how many, but there are hundreds of boards involved in this System. I do not know exactly how many. There are 4,000 people involved in boards of directors of one kind or another.

I think if you really look at their activities, they are not boards of directors at all. They are working committees. There is nobody who you can really put your finger on in many of these associations who is totally accountable because they are all involved in the running of something.

If you are a board of directors as I understand a board of directors, they set the policy and let management run it, and then they demand to management what they expect them to do. It is difficult to pinpoint in this organization.

Now, first off let me emphasize I am not talking about changing it from a cooperative thing. I headed one of the largest cooperatives in the country, Northwestern Mutual Life, a $20 billion organization. Mark came from a big co-op too.

That is not what we are talking about, but creating a system of governance where you can really put your finger on who is accountable, who is responsible. Right now you cannot say that to the board because, well, we did it. Well, how do you get any accountability to "we"? If I did it, you can account to me for it—or make me accountable for it. But this sharing kind of thing, and there is so much of it, that to me would be the greatest place to start if you can get some accountability into the System.

I think also—it just occurred to me—if you had a Capital Corporation, or some other kind of organization like it, handle the workout circumstances and then turn your attention to the System and get them back to where they should be as far as accountability, responsibility to the farmer-borrower. What is their mission? Do you know what their mission is? I do not think anybody else does either.

I have heard a lot of platitudes, but I have never really heard anybody define exactly what the Farm Credit System's mission is, not precisely. You know, everything starts with that pretty much.

Senator BOREN. How would you fix that responsibility by changing the structure?

Mr. FERGUSON. Well, the first thing I would do would be change the way you compensate boards of directors. I would not pay them a per diem fee, and I would not have them around except for 1 day a month.

You know, the worst thing that can happen to top management in any kind of an organization is to have to kowtow to the board, which they have to do when the board is around. If you have them around too much, there is no way in the world that you are not disrupting management's role really in running something.

There was a bank where it was almost half the time that the board of directors was in the headquarters in that district a year or so back. Now how in the world is management to run anything if you have got a board of directors there half the time?

One of the reasons, one of the incentives, in order to make it worthwhile to have to spend so many days because it is per diem. You know, I do not care whether you pay them $10,000 a year, $50,000 a year, an annual retainer appropriately placed would help the governance part of this too.

Senator BOREN. Very good, a very good point.

Are there other comments? As we are starting out, any particular elements any of you would focus on if you had the power to write this bill and restructure this System, or make reforms in, or make changes in it or anything like that that you think would make it more effective?

Mr. Wilkinson.

Mr. WILKINSON. I do not know, Senator Boren, whether I could add a lot to what Mr. Ferguson had said. But I think to streamline the System and create accountability and some of those kinds of things.

The System has grown—it is about 60 years old or so and it has grown somewhat uncontrollably in different directions. There are spores and cones that kind of head off in all kinds of directions. I would venture to say it is one of the most difficult business institutions or entities in this country to effectively manage as it is structured today. If we could streamline that and create accountability, I think that would be beneficial.

Mr. ALLMENDINGER. If I could add just a couple of things, as I mentioned in my prepared statement that I have been a borrower of the land bank and PCA all of my farming career, which has been quite a number of years. I think what is really very important to me as a farmer, and looking at it in the view of other farmers, is to streamline the credit service. In some cases now there are areas where it takes too long even to renew a PCA loan. I think it is those kind of areas that we can work in and really be a much better service to the farmer.

Senator BOREN. If you have an entity like the Capital Corporation doing your restructuring and reworking, that is one of the problems. I know many of the local banks are so bogged down with the problems, if you free them of some of the workouts and the problem situations, they probably could be able to operate more quickly and more effectively. Could they not?

Mr. ALLMENDINGER. Yes, sir, I sure agree with that. The workout groups could take care of the bad loans and the acquired properties. That would free up the other association loan officers to provide a good service to the farmer and rancher that need and want a loan and to work with them so they do not come down into that lower level.

Senator BOREN. Senator Lugar, I am happy to have you sit in with us.

Senator Lugar is not a member of the subcommittee, but he is the ranking member of the full committee, and we are always delighted when he is with us.

STATEMENT OF HON. RICHARD G. LUGAR, A U.S. SENATOR FROM INDIANA

Senator LUGAR. Well, thank you very much, Mr. Chairman. I just want to retrace with the board some of our thinking at the time when the Farm Credit Amendments Act of 1985 was formulated and perhaps other things we should have thought about at the time or might think about now.

As testimony began today, the Corporation was provided to give assistance by redistributing financial resources of the System. The assumption at that point in 1985, even given the dower premises of how things were going, was that there were very substantial resources somewhere in the System given all of these banks and entities. And granted this legislation was formulated at the very end of the year along with the Food Security Act of 1985 and all under the pressure of the emergency, and the assumption was that these

sources might be used by the Capital board such as yourselves. That assumption for various reasons did not work out.

One of the reasons, as I listen to your testimony today, that it did not work out is sort of an extension to the thought that one of you has made that there has to be some confidence in the System by the 600,000 farmers who are making their payments. We have spent—and rightly so—a lot of time with our concerns of those that are not making payments. But in the process of this there are a majority of farmers, a majority of Americans generally who make payments and who want some confidence that virtue will be rewarded in this respect.

So it turned out with some of the banks. They said we are not going to give you men this money because we think there are other banks that are being badly run and we think they will be continually badly run. And to give our good money to that sort of a situation is ridiculous.

So however we might have thought about the situation here in terms of spreading the wealth, making available what we had to everybody, that did not work out. I think we are stymied, at least in that situation for the moment.

Unless there is some confidence in this System, that may be continually the case because the individual farmers continue to leave even as we discuss this problem. Sound farmers are leaving the System every day. The various banks that are still alive do not want to cast their lot in with those that they think are still mismanaged.

The second problem is that it seems clear to me that we thought you had more authority than it turned out that you did. I do not think you had very much at all. We should have had more time to walk around the problems we have, as we do now.

For example, at the time of restructuring of the Chrysler Corporation, in that particular legislation we fashioned a board of three people that included the Secretary of the Treasury, Chairman of the Federal Reserve, and the head of GAO as I recall. Now these people had a lot of authority. There was not going to be a dime to Chrysler, to the UAW, to the States, to the creditors, to anybody, unless they said go or no go. And they had an opportunity to make certain that the resources of the citizens of the United States—and the taxpayer resources that we are thinking about in this legislation now—were well used.

I do not know that is what we ought to demand now, although I am tempted to think something close to that might give confidence to the rest of the taxpayers. But for us to put money into the Farm Credit System at this point without there being some confidence that somebody is in charge, that somebody can ride herd over the whole business it seems is almost to provide another disaster as well as a lack of confidence and possibly not even the votes to pass the bill to begin with. It would be a great lack of confidence.

I suppose what I am wondering is if we had been wise enough and we had said no money in November 1985 unless there is a board here that can watch over everybody, can soak up these loans that are troubled, can in fact distribute money to the rest of the System as is required, if in fact they perform and deny it if they do not perform, would we have made more headway?

In fact, is the board as it is now constituted, the five of you, or others that might be in a position given this kind of System as opposed to Chrysler or as opposed to the Federal loan guarantees in New York City, another example where Congress has tried to get into a very complex job, would you be capable of handling this or would it work if you were given the same authority, let us say of the Chrysler board if you take that instance?

Mr. Ferguson, do you have any general comment about that?

Mr. FERGUSON. Yes, I do. And I am not so sure, Senator, that it is the lack of authority here as it is the lack of funding. I also would caution you in writing legislation—it would be my advice anyway—to be careful of the trap of a Chrysler-type corporation.

That was one borrower. Here we are talking about 250,000 people in it rather than 1. It is going to be an entirely different kind of a role. You cannot expect the same kind of results from a structure that is like that when you are dealing with 250,000 borrowers. It is going—this is going to have to have an oversight review and/or authority if you go that far.

I just caution you, do not get caught in the trap of a Chrysler type bailout corporation. Because I do not think it is going to work that way.

Senator LUGAR. Granted that you are right, there is 1 borrower as opposed to 250,000. What does that imply, that you have much more of an organization to oversee?

Mr. FERGUSON. Right. Right now we have in total something around 800 people. And we are not in anywhere near all the districts nor are we in most of the districts with both feet. This would require I would guess probably ultimately three times that number.

So you are talking about a massive administrative job compared with, for example, the Chrysler bailout circumstance, or the deal in New York.

Senator LUGAR. Well, let me play that whole scenario back the other way. We heard testimony last week from the president of the St. Paul board. He described how in that particular instance they have had remarkable success in working out loans and restructuring loans and sales of land at the appraised value or higher, restoration, at least as he saw it, of the leveling off of land values so that if there are any speculations it is likely to be moving up rather than down, a number of things.

But he also made the point that one reason he is able to do all of this, that he is not involved with Capital Corporation. At least as I recall, he said those banks that have gotten into the toils of the Capital Corporation have had very great problems in taking such aggressive measures, comprehensive measures as he described.

Now, what do you make of that kind of testimony? Here is a man apparently on a bank board having some success. I was impressed as we took a look at the landscape how well they are doing out there. His testimony is that he has managed to evade difficulties or control by you gentlemen.

Is that a unique case in which you say by and large there was a man that sort of went his own way and it worked out, but for the rest they are unlikely to do so and rather than looking at this as a

rule it is an aberration? Or do you have any thoughts about the St. Paul situation?

Have any of you surveyed that and have an idea of what is going on out there?

Mr. FERGUSON. I would just as soon take a shot at that a little bit.

We have approached these things with the knowledge that we do not have a big pot of money someplace nor is it forthcoming. We have tried to base this on the best business basis we know how, and with an appropriate amount of compassion.

It is obvious that the efforts of the St. Paul bank have been very successful in what they have tried to do. But after some conversations with the Capital Corporation people who questioned some of those—and I think that is a pretty well-known situation, that there was a little, not actually a fisticuff, but disagreement about the approach on some of these things. The St. Paul bank has now changed some of their approaches, that we were able to convince them that maybe this was not exactly the best thing in the long run. And there have been some changes.

That still should not be a criticism of the St. Paul bank for not having made a good effort. I think they should be complimented for that. I think also it shows how effective the Capital Corporation could be. Even though we had no control whatsoever over the St. Paul district, but having some people in there and talking to them and going over case by case and showing what our approach might be and they changed their approach to a great degree, Senator.

Senator LUGAR. On the case of the St. Paul Bank, you did mention that due to the collateral decline, they will have problems in terms of selling the bonds in the summer. I presume that if everything had worked out well for the Capital Corporation, you could take a look at the St. Paul situation and you could help them out if you had the money.

Mr. FERGUSON. Precisely.

Senator LUGAR. In other words, one of the dilemmas, even in the best run situations right now, is that they are going to be thin in terms of trying to sell the bonds even if they are doing a good job; the turnaround is coming. And thin as you gentlemen have become, you do not have any money either. Everybody is blocking with lawsuits and so forth. Even in the best run situations you cannot help them right now.

So they have to come to us too. And whether it is well run or badly run, all sort of cup-in-hand, hoping that the Lord will provide and carry things through this situation.

Let me just make one final remark. You mentioned you had 800 employees presently, and if you were to do a comprehensive overview of all these loans, it may be three times that many that may be required. Just physically where are they housed? Is it all in one place or how do you organize your own efforts around the country?

Mr. MACKLIN. Actually, Senator, there are about 40 of the staff in Kansas City where the headquarters are. The rest are distributed through the four banks in which we operate. It is related pretty much to the number and size of the account. We have a small group in the Jackson Bank, a large group in the Omaha Bank, and also in Wichita and in Louisville.

Senator BOREN. You mentioned, Mr. Ferguson, some of the changes that took place in terms of these negotiations and discussions with St. Paul. What were the major changes to take place in there?

Mr. FERGUSON. You would have to get somebody that knows the details of it.

Mr. MACKLIN. Senator, the major change was in the careful documentation of the analysis before the granting of any extension or any restructuring program. They were very anxious and moved forward almost in a blitz fashion to get to a certain goal. You really have to applaud them for the courage and the effort to do that.

But in that they escaped somewhat what we thought were our policies for restructuring and good solid credit underwriting. We sat with them, talked to them for a great while. They moved away from the blitz approach to a more deliberate, cautious approach, hopefully to accomplish the same thing.

Senator BOREN. Senator Cochran.

Senator COCHRAN. Thank you, Mr. Chairman. Recognizing that the Capital Corporation has over 800 people involved in it and hearing the statements made by some members of the committee and some members of the panel about the importance of streamlining the System, I wonder whether or not it might be indicated that the various districts form their own watchdog committees for a "disciplinarian to protect their interests," I think as Mr. Hughes described it in his prepared statement, to supervise a review of the bad loans or a working out of the nonperforming loans rather than investing the assets of borrowers, which is what we are talking about, in an entity like the Capital Corporation.

I do not want to try to get you all to admit that you are dispensable or that we could all do without you. That is not what I want to do. But I wonder whether or not that is an obvious change that ought to be made.

Mr. MACKLIN. Senator Cochran, first of all we are dispensable. I think it is very important that the Farm Credit System in the long run get rid of the Capital Corporation and any of the other additional costs that you must have.

As a guy who has spent most of his career competing with the Farm Credit System I know that the competitor's costs are lower. And we need the Farm Credit System and we need to get those costs down.

However, I think in reality the focus that an outsider is able to put on a group of young men, the narrowing of the responsibility, and that third-party approach to the problems lets them be a little more effective than a group controlled at home with the problems that might be political or might be biased one way or the other.

I do not think there is any question about the folks at home being able to do the same thing. It is a matter of do they have enough time to do it? Would it take 3 years instead of 1 year to do it? And would it allow them to zero in on the good side of the business.

The good side of the business, as you know, I know, is suffering. There are too many good borrowers that are going into association offices and not getting the proper attention, partly because the young man that is in there has been stalled with all the bad infor-

mation that we have been feeding them. I think one of the critical things is to address that, shove it off on the Capital Corporation, let them work their way through, get rid of the Capital Corporation at the proper time, and at the same time force the System on some sort of a recovery program.

Senator COCHRAN. Is there any other reaction? Mr. Hughes, I was particularly interested in your reaction to this.

Mr. HUGHES. Well, I feel, Senator Cochran, that since 1978, when all banks went on each other's bonds the System needs this added device. Prior to 1978 the land banks were on each other's bonds; the credit banks were on each other's bonds. The bank for co-ops were on the BC bonds. But in 1978, all banks went on everybody's bonds.

And, that is when the 37 bank loss-sharing agreement was put in place. There is a mechanism in that agreement to provide some discipline. But it is not as strong as you would like it to be. I think it needs to have more strength rather than those disciplines folks are willing to impose upon each other. This is a very hard thing to do, but as you know, all these things are hard things to do to your friends and neighbors.

Senator COCHRAN. But do you agree with Mr. Macklin that this is an entity that should be phased out or terminated——

Mr. HUGHES. As far as Cap Corp is concerned——

Senator COCHRAN. And it may be sooner rather than later.

Mr. HUGHES. Yes, sir. As far as Cap Corp is concerned, I think it has a very specific job to do. And it should do it. And then it should close its doors. I am sure that everybody around here agrees on this end of the table with that notion.

Now, you say well, that does not give it the continuing responsibility to perform this monitoring function, and in your legislative wisdom you may conclude that is a desirable thing to do. However, when you came to that point, the staff size of Capital Corporation would go from whatever the number might be at the peak down to a very much smaller size.

Senator COCHRAN. One thing that concerns me is that after this period of crisis is over, there are going to be loans that go bad.

Mr. HUGHES. That is right.

Senator COCHRAN. Unless there are in place those individuals who are going to be imposing some discipline in the management of the System, who know how to make the decisions and are prepared to make the decisions and maybe have gained some experience as a member of a watchdog committee or some other committee, then we are going to start all over again and have a problem that is going to start developing anew once the Capital Corporation does go by the wayside.

That is one thing that I was hoping to see if someone could help us develop. That is an in-house or an in-system capacity for discipline. What we are seeing now is an emphasis on outsiders coming in and reviewing what really ought to be a management activity, and unless we have that person or that entity develop from within the System, what is going to happen after we try to work out the normal operations of the System at some time in the future?

Now, what is your reaction, Mr. Ferguson, to that?

Mr. FERGUSON. Well, first off I would like to correct an impression I think maybe that I gave. These 800 people now, and maybe 2,400 ultimately, are not new additional people in management. They are people who have been taken out of the System to a—what maybe, there are 20 or 30 who have not been taken out of the System, at the very most, out of 800.

So it is not a duplication of personnel. I just wanted to be sure that you understood that. I think it is a question of dimension, of size of the problem. If you have 4,000 loans in your portfolio and 2,000 of them are in trouble and have to be restructured, now you have got a massive, enormous, in fact gigantic job to accomplish.

Once that is accomplished and you have got 40 loans that need restructuring out of your 4,000 portfolio, that is an entirely different kind of problem, and any management that is worth their salt ought to be able to take care of that.

But you have got such a huge job that is a different kind of management job in a workout circumstance. I see that very thing in Continental Illinois. I happen to be on the Continental Illinois Bank board. I was one of the new directors after it went through its problems. So you see I am getting exposed to this kind of situation.

I see the same thing there, the workout group that works directly for FDIC there. It has nothing to do with the bank. The bank is now going back and working for their customers and trying to build a profitable, decent bank. And I think that is the kind of thing we have to emphasize for the Farm Credit System and put our efforts there.

Senator COCHRAN. What are the different experiences that you had among the districts in which you have a grievance now? You mentioned, I think, Mr. Macklin, five Federal land bank districts and two districts where you have a grievance with the production credit association. Have your experiences been about the same in each district or what are the differences?

Mr. MACKLIN. They are all a little bit different. If we had it to do over again, we would probably fashion an agreement that was a little more customized to the districts. We sort of started out plowing new ground and we made one agreement and used it for all of them.

But there is a variation. For one thing there is a variation of size of loans and the type of customers we are dealing with. And there also is a difference in the expertise and the conscientiousness and the staffing of the various banks. So there is a certain amount of difference that we have to deal with.

There are various levels of management experience and management capability that make a difference. There are various levels of staffing within the bank itself. There are various levels of enthusiasm, as a matter of fact, for this sort of onerous job.

In one of our banks we found that there were some 60 loans in excess of $1 million that had not been addressed for nearly 14 months because it was a very difficult job. And rather than tackle that, they let that soak in hopes that things would work out. That is a comfortable way to do it, but it is not a very successful way to do it.

Senator COCHRAN. Someone in his statement mentioned that one of the reasons why the System got into the difficulties it did was the fact that there was no regulator, there was no entity which had the responsibility as an arm's length regulator. And I am not sure we have answered this, but is the FCA now equipped with the powers and functioning as the kind of regulator that will make the System function in a businesslike way and offer the hope that the System will not fall again into the troubles of the past?

If not, what needs to be done to help that?

Mr. MACKLIN. I think Chairman St. John has some specific thoughts on that.

Mr. ST. JOHN. It seems to me that they are having somewhat similar problems to our own. You have to keep in mind that group has only been in place for 18 months. They are trying to feel their way along as to what the proper role of the arm's length regulator ought to be.

We see a little different—not a little, quite a different function that we would perform. We are looking at trying to get into the bank so that we prevent them getting into trouble as best we can. Those that are in trouble, we try to get them out of trouble if we can.

The arm's length regulator by and large comes in and after the fact he sends in examination people, they see what has been done right, what has been done wrong. They write up the report and they ask the banks to respond to that and to make whatever changes.

Often by that time it is a little late. We look at our role of getting in there a little bit sooner than the arm's length regulator. I would not presume whether they say they have sufficient power to do their job, sufficient authority. It seems to me on the surface that they probably do. But I think their role is quite different from ours.

Senator COCHRAN. I apologize for——

Senator BOREN. No, I think we all share the very same concerns that you have. Go ahead.

Senator COCHRAN. I have a few more questions, Mr. Chairman. And then I will yield to others.

Is there any suggestion that you have about how the Capital Corporation should be phased out or, as a Congressman around here liked to say, "sunsetted"? We like to use nouns as verbs in Washington. I do not know how we got around to doing that, but you will notice that we add i-z-e on nouns and they become verbs. But we also do it with words like sunset.

How would you suggest that we go about doing that? Should that be written into this bill?

Mr. HUGHES. I think you have a sunsetting in there.

Senator COCHRAN. We have it in there already?

Mr. HUGHES. 1990. It is entirely possible that in its wisdom Congress may choose in 1990 to advance it for 2 years or something like that if the job has not been finished up. But that is the way, it seems to me, it will play out.

Senator COCHRAN. And you would not recommend legislation that would terminate the Corporation at this time or phase it in at any earlier date than the 1990 sunset date?

Mr. HUGHES. I think that the question of when it should be sunsetted is unknowable at this time.

Mr. ST. JOHN. Senator, if I may respond a little bit further to that other question that you asked, we view our role as getting it only to the troubled banks. At the moment that is something like 7 out of 37. Most of the banks are viable and still going. We do not intend to take, want to take, hope we never have to take, any role in those viable banks. Of course, a regulator would have to regulate all of them and does examine all of them. I think that is the big difference.

There are a number of banks that we are mixed up with. It is quite different from the number that a regulator would be interested in.

Senator COCHRAN. Thank you, Mr. Chairman.

Senator BOREN. Thank you, Senator Cochran.

The Chair has just one quick question and then unfortunately, I have the misfortune—we can never plan our schedules around here—of managing a bill that is on the floor. Those that have been standing in for me are sending me messages to return to the floor. I will ask Senator Karnes, if he will, to Chair the remainder of the hearing.

Some of the banks that are in difficult circumstances, some of the districts, you have worked out agreements with and are working quite successfully. I think you said you are fully involved with two or three of the banks and have one foot in a couple of others. Some I gather are not too horrible yet, but are still experiencing some difficulty.

Is this just a management attitude? I know, for example, in the—and I am not trying to put you on the spot about any one bank, but in the Wichita bank—and I have no idea whether it was the right decision or the wrong decision. They have not yet entered into an agreement to turn over all nonrecurring—nonperforming loans. There has not been a full agreement reached yet between the Corporation and the district to establish that.

Why are we seeing such a variation? Is it due to different economic circumstances, ways in which losses would be calculated that value collaterals would then have to be written down and losses taken by the districts or the local association, or why is that? What are the kinds of concerns say that—let us use Wichita as an example—lead to this kind of hesitancy or decision in some cases not to enter into an agreement, a blanket agreement, on nonperforming loans?

Mr. MACKLIN. Senator, Wichita is the only case that we have been able to make an offer to acquire those assets by assume debt. We have not been able to do that in other banks. We did that because we had had actual cooperation with Wichita, we had what we felt was one of our better staffs there, we thought we could make the transition pretty reasonably. And their staff and our staff really developed the economics of that business decision.

They decided that this was not the appropriate time to make the transaction.

Senator BOREN. You have actually taken over the debts?

Mr. MACKLIN. We would have, yes, sir.

Senator BOREN. And they would have had to recognize a certain loss on the value of those at the time the transaction took place?

Mr. MACKLIN. Yes, yes, sir. They would have had to have written those down. But the write-down would have been within the range of their own accounting stance. There was one discrepancy and this threw the monkey wrench into the deal.

Their staff and our staff in analyzing the some 5,000 loans that we were working on found that their appraisals were about 10 percent too high. They are better traders than us, they settled on 9 percent. But we had to factor in that much additional and it made the discount look high.

Senator BOREN. But ideally this would be the way you would want it to work in the district since you are going to work it. You could come up jointly with agreed-upon appraisals, the current value of those loans. The idea would be that you would actually take over that debt.

Mr. MACKLIN. Buy it, yes, sir.

Senator BOREN. Buy it, and that would be the ideal kind of situation. Then what would be the circumstance if you left that district? I am not saying it would have occurred in this case, but suppose you left that district under water? Would there then be a capital infusion or loan from the Corporation then to enable the district to continue to function?

Mr. MACKLIN. They felt that if we separate these bad assets that we would reduce their total interest costs by about a quarter of a percent, which would allow them to push that down to the borrower and hopefully increase their business.

Senator BOREN. Generate their business, the kind they want to generate?

Mr. MACKLIN. Because it is bleeding off right now faster than new loans are generated.

Senator BOREN. Yes.

Mr. MACKLIN. So it looked like that would help the good side——

Senator BOREN. They would have to be in a position to take the writedown thought?

Mr. MACKLIN. Yes, sir.

Senator BOREN. They would have to have the capital position to do that?

Mr. MACKLIN. Yes, sir. And in their instance they did have an allowance for loss that allowed this.

Senator BOREN. They had sufficient capability of doing that?

Mr. MACKLIN. Yes, sir.

Senator BOREN. So really it is the kind of concept I suppose you are still, are you still trying to work with them? For example, to see if there could be some——

Mr. MACKLIN. We would like very much to open up that trade again. We are at a little bit of a standoff right now. I do not think the issue is completely closed. We would be very happy to open that again. We are talking to the Louisville Bank about a similar——

Senator BOREN. What could you say to a district? Let us say we had district *x* out here. We will take names off the districts where you want to do that, where you get down to a situation that you have an agreement on the values and everything else. But the dis-

trict would be left under water where it did not have sufficient capital reserves to take care of the losses. They would have to recognize up front to do this. Would you then arrange to make some sort of advance if you had the resources? That is the problem.

If you had the resources, then you would arrange to go ahead and make that kind of an advance to them to keep them from going into an insolvent situation.

Mr. MACKLIN. Yes, sir, that would be ideal. If we could meter money on that side also. But of course that is not possible at this time.

Senator BOREN. Under the current circumstances. But if you had the money, what I really hear all of you saying is if you had the financial resources as we originally thought you would have—again, I would have to make the subcommittee realize we are going to have to come back and write some sort of a fair balance here. In other words, we understand that those districts that are in very good shape are not exactly anxious to rush in and help those that are not, especially if they think they are not being very well managed so they are going to get in trouble all over again.

I can understand how some of the districts would feel about that, and also what the fair value of the franchise is and what the maximum amount of sharing would be, those sorts of things.

But as I hear all of you saying it, if we could work statutorily a fair formula along those lines that would meet at the median, I am sure everybody would be a little dissatisfied with it. Some would think the healthy districts would not be giving enough. Healthy districts would probably be feeling they were having to yield too much, especially if we could put some protections and management standards in the future.

What I hear you all saying is that you still feel very strongly that with objective analysis, the ability to restructure, the ability to take the problems off the hands of the district. That district then, the whole system, would have a better chance to operate by keeping the Capital Corporation fulfilling these functions than it would be if we went to some sort of immediate end or so forth.

Is that in essence a fair summary of what you are saying?

Mr. MACKLIN. That is exactly it.

Mr. FERGUSON. It would surely remove much of the friction between the Capital Corporation and the balance of the System if there was some quid pro quo on this sort of thing that we can fund ourselves as the Capital Corporation.

Senator BOREN. Yes. That is the problem as I see it now. You talk about a blackout and a white out. It is totally a blackout if you really do not have anything you can offer them. You do not really have anything you can offer until the Capital Corporation has some capital so to speak with which to work. I understand.

I appreciate very much, and I apologize again to you. It is just a circumstance over which I have no control. It is another example of how things operate or do not operate on a rational basis. I will turn it back to Senator Karnes.

I appreciate your closing this out. Please feel free, and Senator Lugar, to ask as many questions as you want. I know Senator Daschle is trying to make his way back over here, so he may appear shortly too.

Senator KARNES [presiding]. Senator Lugar, if you have additional questions, please feel free to proceed.

Senator LUGAR. Let me just follow up with this thought: obviously if you had money and you were able to perform some of the deeds that Senator Boren has mentioned, and as you say friction with the other banks is lessened substantially, but the problem that we faced in 1985 was that the Congress did not want to appropriate more money. Congress saw money in the System and hopefully gave you the ability to obtain money from the System with which you would perform these good deeds.

And I suspect we will still have that problem in 1987 in terms of appropriation of new money given the budget situation, the fact that the country is trying to lower the deficit and not increase it.

Do any of you have any idea as to how money is to be raised for this if we are not able to work our way through the System and everybody retains all of their losses and all their positions there? Clearly there are voices who would come and suggest we simply appropriate it. Forget the Budget Act or any other discipline that happens to be involved and just infuse money to you or to some other group that will handle this type of thing.

But as I say, I think that is unlikely. And so we are back to square one again. And I would appreciate any thoughts that you have just as citizens generally, leaving aside your roles as Capital Corporation board members as to how this would be financed at this time.

Mr. FERGUSON. Well, yes, we have been wrestling with this thing too. I think that every one of us wants to hold down the contribution that the taxpayer makes as much as possible in all of this. Knowing that someway or other the full faith and credit of the Federal Government in one way or another is going to have to be applied here, how do you do it most efficiently?

One of the advantages of a Capital Corporation or whatever you want to call it, create another entity and get somebody else to do it if that is what you want, but you are going to have to have somebody perform this role. If we can have some uniformity involved, before you take the acquired properties for example, we doubt 10 or 15 percent of them that are probably pretty crummy kind of properties anyway, many of them that should probably never have been put in crop, water, wind eroded, or maybe swamp land or just plain scenery, never should have been put in crop and are not possible to continue in crop unless you have got exorbitantly high farm prices, which we certainly do not see in the offing, so you take out that little part of it, and that is probably going to be the most expensive part of funding this whole operation. Take those away, I think—in fact, I have been fussing with this for some time with people on Wall Street that I have known for a good while, where we could get, oh, $1½ to $6 billion, in that range, using these acquired properties as collateral for these at a 5 percent interest, 4½ to 5 percent interest rate, which is about 300 to 325 basis points less than the System is now paying.

Let us just say we had $500 million of these acquired properties, and 300 basis points is $15 million a year that you are saving on that particular block of business. The tradeoff on this sort of thing is that if in fact you made some money at the end of a 10-year

period, say they are 10-year inventories, you split the profit with the bond holders, 75 to the bond holder, 25 percent to the Capital Corporation that ultimately goes back to the System.

Now, you can argue whether you are giving away something in the future. But you are giving away something in the future obviously for a certainty of 300 basis points cost today.

That is one way of doing it on acquired properties. And I think the fellows that I have been talking to on Wall Street feel there is enough risk money out there, would be interested in some of this, maybe not just U.S. money, some of it could be foreign money as well.

Senator LUGAR. Now, just to restate that, you take 85 percent of the properties, in other words, what happens to these 15——

Mr. FERGUSON. I say that is going to be the expensive part of funding. That I think you might just as well be candid with yourself. That is going to be the U.S. Government's problem.

Senator LUGAR. How much money is involved in those?

Mr. FERGUSON. I do not know that there is a lot of money involved, but there are an awful lot of borrowers involved. It is the small end of, and the poor end of, the properties. Do you have a feel overall what that——

Mr. MACKLIN. Approximately $1 billion in acquired properties.

Mr. FERGUSON. But how many in the loans, nonaccrued loans?

Mr. MACKLIN. Acres?

Mr. FERGUSON. No.

Mr. MACKLIN. You mean numbers?

Mr. FERGUSON. Dollars.

Mr. MACKLIN. It is about $6 billion in total nonaccrued.

Mr. FERGUSON. Nobody knows how many of those $6 billion are going to end up in acquired property either.

Senator LUGAR. But in any event, just to follow up on your concept, you try to segregate those properties that are relatively impossible in terms of crops. Let us say they are extravagant prices which are not in the offing, and therefore they are nonviable, cannot work out for anybody at anytime, and you set those aside.

Then you have a block of troubled properties and all of those in one form or another come to you in a block from all these banks, just sucked up into one ball of wax, and using that as collateral, you, that is the Capital Corporation, borrow money from corporate—or from Wall Street investors, maybe as much as $1½ billion to $6 billion. You do not really know how much it will take, but you see what you have.

But you borrow this outside the Federal Government given guarantees—I suspect you are looking to the Federal Government for guarantees in this. But nevertheless it is privately done. You give the investor an opportunity to get 4½ or 5 percent on his or her money now with the hope that if you run this thing well, in 10 years you might get three-quarters of whatever you made.

It is on that basis that you get a very low interest rate now, thus saving the whole System in one form or another, as you say maybe $15 million a year if you had that kind of spread of 300 basis points, and the Capital Corporation runs this business. All the troubled property in the Farm Credit System all over America with

money that has been borrowed outside the taxpayers or appropriations of Congress or that sort of thing.

Mr. FERGUSON. I think it also has one other tremendous advantage, Senator. With very low interest costs—now you could carry this to the extreme and go with a no-coupon bond that is discounted where your interest payments are not due except until the end. So you can handle it any way you want to. That is just a question of using your pencil.

But the tremendous advantage of this is there will not be the pressure to liquidate, that forces so much property on the market, that it continually depresses the market more and more and more.

Senator LUGAR. Quite to the contrary it is in your best interest if you make all these things work.

Mr. FERGUSON. Absolutely.

Senator LUGAR. In that case you make more money, as does everybody else.

Mr. FERGUSON. Uh-huh.

Senator LUGAR. And you do not have the pressure of Congress looking at the appropriations every year or that kind of oversight forcing you into unusual business judgments in the process. You can sort of take your own time and that of the borrowers I suppose over this period of time.

Mr. FERGUSON. There is such a tremendous amount of this pressure that is overhanging the market, not just in the Farm Credit System, individuals, rural banks, and you add pressure of the Farm Credit System also liquidating, you have got a huge downside pressure on the market of farm property.

That is one of the great values of this kind of approach, it reduces part of that emphasis of trying to get your money back right now.

Senator LUGAR. Just to follow that up, how can we get all of this property over to you? Right now you are arguing and negotiating and what have you and all sorts of things. For a variety of reasons, good business reasons, some will let you work on these troubled loans and others do not. And for this to work in the uniform way which is fair to every American, every State, and every county, there has to be some uniform application of this, everybody's troubled properties all in the same pool.

So apparently the legislation we are facing has to somehow get to that point. Do you have any suggestions as to how to get to that point?

Mr. FERGUSON. I sure would have the attorneys working on that one and be looking over their shoulder to——

Senator LUGAR. Now granted that is a legitimate question that has to be answered in legislation.

Mr. FERGUSON. Could be.

Senator LUGAR. Because otherwise you have got the same checkerboard pattern.

Mr. FERGUSON. Exactly.

Senator LUGAR. In about four sections of the country you are working out loans; three or four others they do not want any part of you. In essence you have a hodgepodge, you have no deal. It is to me just a collapse of legislation.

It may be that something in the thread of that makes them more cooperative. If we are not able to get the cooperation in all the System, the thing you are talking about or any other schemes are not going to work.

Mr. FERGUSON. That is right.

Senator LUGAR. Nor will there be an infusion by this Congress of money anyway. There is not going to be any money until there is a scheme that looks like it is going to work because there are just a good number of people who are hard-headed enough to say that good money ought not to go after bad just simply because we have a purported emergency.

But that is still to happen. I am just curious as to how in the most equitable way it can occur so that every part of the country feels that there is fairness and those people that are paying their bills feel that they are being dealt with fairly and those that have not been able to think that they are not going to be under pressures.

I like your idea of a 10-year situation, sort of really outside the appropriation process, outside the pressures and that type of thing, but with people trying to make money to give back to your board and even back to people loaning the money in return for low interest rates to begin with.

Thank you, Mr. Chairman.

Senator KARNES. Thank you, Senator.

I would comment on that, having spent the last 4 years as Chairman of the Federal Home Loan Bank of Topeka where we have taken a great deal of property back to the Home Mortgage System in Oklahoma and the western slope of Colorado. We have set up an entity we call a 406 Corporation to do what you folks are doing. It deals with the distressed property, removes it off the books of the institutions and allow them to deal with the good borrowers without the concern and the constraints of having to deal with all these problems which take, as you very well described, so much more time than dealing with the good borrowers.

But of course the 406 Corporation used a consignment program. One corporation was not funded with the type of resources to enable it to acquire from the institutions that put assets on the books, the assets themselves, but the Federal Asset Disposition Corporation did go to the marketplace and raise $50 million worth of funds initially, and then an additional $50 million through Wall Street and backed by the Federal Home Loan Bank system itself. Interestingly enough the Federal Home Loan Bank system is staying together as a system. And it has avoided any lawsuits back and forth within the System.

As a result, the Federal Home Loan Bank system has been able to go to the marketplace and secure financing at a spread not that far off treasuries. And there are some advantages, some real advantages in the mind of Wall Street, in having a system continue as a system.

I want to compliment Mr. Ferguson and some of the other folks who have had input on that recommendation. Though frankly, I am concerned about having the Government holding millions of acres of farmland in its inventory in some governmental entity and operating those farms. Having been in the commodity business, I

think people feel that a sale to the Government, or a quasi-governmental institution, is not a sale.

The land assets are still there. They still hang over the marketplace. They still have a negative impact on prices. But you do remove them further from the actual marketplace. What you have right now is an effort to liquify those assets as best you can and as quickly as you can. That has a depressing effect on prices right now.

I think we have the genesis of a concept here that we might want to pursue further. I really appreciate that.

It leads me to just one other comment, which is maybe more the threshold question, which is—have we identified all the problems within the System so that when we actually take care of the problem right now—I think this is what Senator Cochran was addressing—will we be out of this boat? In 10 years, when we systematically have put those farms back in private hands, will we not be back here again dealing with some of the systematic problems that I think all of you have touched on in terms of management problems or restructuring problems? When we do restructure let us make it a meaningful restructuring.

I am the youngest U.S. Senator and plan to be here a long time. I would just as soon let you folks stay out there dealing with the regular aspects of the business, and not see you again for another 40 or 50 years.

I understand that there has been a report done on one of the banks, one of the district banks, that took a look at the decision-making process and tried to identify some of the problems, and which we should have, so that when we are called upon to make an analysis and decisions on restructuring legislation, we will be doing it with an eye toward what caused the problems.

I believe, Mr. Ferguson, that in the Continental Illinois situation the Securities and Exchange Commission came in and had a study done. It was a complete analysis of what caused the Continental Illinois situation, and that report provided some guidance to the regulators in formulating a solution.

I am wondering, although time is of the essence right now in terms of the problems that we have in the System, my question is: Have we identified all of the issues that should be addressed in the legislation? Maybe it should be done in a fashion much like this SEC report on Continental Illinois. Have there been some studies done of the System banks so that we can identify for the farmers, for the taxpayers, and for Congress, the scope of the problem so that we can have meaningful legislation that will deal with the problem, and so that we will not be back here again?

Has there been any type of study of the Omaha bank or some of the other banks as to why the problems developed, and is there something that we could see? Or maybe there is no such animal.

Mr. FERGUSON. There is a report—it is called, I think, the Gallagher Report—that has highly confidential stamped all over it. I do not know how confidential it is any more. But if I were in your shoes, it would certainly be one that I would subpoena and find out what that report has to say.

Senator KARNES. Who is holding this? Was that a report done by the System itself?

Mr. FERGUSON. No. It was done by a law firm in, I think, Portland, Oregon, or Seattle, one or the other. It is about the Spokane—some of the problems of the FICB and the PCA in the Spokane district.

There is also another study I think that was done by FCA on large loans run, I remember $500,000 low to 5½ million high, again in the Spokane district. And it goes into it in great depth. It is—again I think it is something that your staffs really ought to take a look at.

I think that was available from the FCA. I think they are the ones that prepared it. I am not sure, but I think that is right.

Senator KARNES. Do you feel comfortable right now that if money is inserted into the System, that it will be used wisely by the System? Have any of you had a chance to take a look at some of the legislation that is pending as far as restructuring?

I am giving you a chance here to give me some input as to what you have seen as far as Congress' effort in this regard. Are we taking the type of steps to make the System a proper steward of any taxpayer funds that we may put into the System, as far as bolstering the System?

Mr. Macklin, have you had a chance to——

Mr. MACKLIN. Senator Karnes, I would like to have Chairman St. John speak to that. We have talked some about that, but he has——

Mr. ST. JOHN. I think on the subject of restructuring I think it is impossible to judge on a short-term basis the success or the lack of success of a given restructuring program. It is easy enough to go in and restructure loans. That is not a real difficult thing to do.

But the real test of it comes a couple of years later when you find out whether or not that restructured loan has indeed gone back on the accrual roles or whether you find the same loan on the same farm back on your plate in a couple of years.

I guess only time will tell on some of those. But I urge you just not to—if somebody has restructured x percent of his loans, do not jump to the conclusion necessarily that that has been a tremendous success. You do not really know how much of a success it is until the passage of time determines what has happened to that loan.

Senator KARNES. Sure, you make a good point.

Mr. MACKLIN. Does that address your question, sir?

Senator KARNES. I would agree with that analysis. Only time will tell how successful you are with any of these loans.

I guess I am more interested in whether you folks who have had a chance to deal with some of the assets of the System, if you have also had a chance to form an opinion on the restructuring that has been done by the System to date. Is it indeed a meaningful restructuring that would, in your opinion, alleviate some of the problems that caused the Capital Corporation to be formed?

Have you seen the type of restructuring or the type of reorganization that you feel is appropriate for the problems at hand?

Mr. MACKLIN. I think, Senator, in the long run there has to be further restructuring to fit the scale of the business that the System now has. It has gone from $80 billion down to $50 billion. In that process some of the organizations and the operations that

were set up to appropriate probably are no longer appropriate. We have not really addressed that from a systemwide standpoint because we only deal with a handful of the total number of banks.

But I do not think there is any question that—in Enid, Oklahoma, for example, there is a small land bank on one side of the town and a small production credit on the other side of the town, neither one of them are large enough to really be a viable organization. In some way I think we have got to get that joined together so that a producer-grower can go to one organization, talk to one man and solve these problems and consolidate whatever volume there is, because it is a lessening in all areas, so that is a viable, ongoing business with one man to talk to instead of having a sort of divided operation that we have now.

There is movement toward that. Mr. Howell Hughes' organization in Springfield has for many years had single management. They did that without interfering with the separate entities of the FICB and federal land bank, just through skill in managing their organization.

But that is really unusual, especially in the troubled areas where we are. There still is a certain amount of divisiveness. That is probably the wrong words. There are some problems within the organization, yet in the banks that have problems that we are dealing with that need to be addressed.

One thing I think that is appropriate, when and if money is put into the System, I think it is imperative, as you know having come from the business which you just completed, that there must be some sort of a recovery plan established and we must monitor and stick to it so that we can go from where we are to something better from an economic standpoint.

Senator KARNES. Very good points. I appreciate that very much.

Would any of you care to make a final comment for the record? I will probably be completing the hearing unless you have anything final to say.

Mr. MACKLIN. Chairman St. John, do you have a windup?

Mr. ST. JOHN. I have no windup as to the testimony, Senator, except that I would like to say that we appreciate tremendously the reception that you and your colleagues have given us this afternoon. I take heart in that and I appreciate it very much. Thank you.

Senator KARNES. Mr. Hughes.

Mr. HUGHES. I hope that we can all remember that there is a black hat to be worn and that somebody is going to have to do that. I believe that the present Capital Corporation has a 2-year start on that. The System would do well to capture the experience of the last 2 years of Capital Corporation.

Mr. ALLMENDINGER. The only thing I would like to say, Senator, is that I hope the end result will be a Farm Credit System that will continue to provide good credit to the farmers and ranchers and their cooperatives in this country. The Farm Credit System has served agriculture well for many, many years. I certainly hope that the end result again will be a good sound Farm Credit System.

Mr. WILKINSON. I would just say thank you, sir, for hearing us out and I urge you that if you do put funds into this System that

you make sure they are carefully supervised and that they go to the benefit of the farmers and the ranchers.

Mr. FERGUSON. I have nothing to say except this: thank you much and if I can be of any assistance to you or any of your colleagues on this subcommittee, I would be more than happy to be available.

Senator KARNES. Mr. Macklin.

Mr. MACKLIN. Senator Karnes, I also thank you very much and thank your staff for the help that you have been to Capital Corporation not only today but in the past couple of weeks when we have been wandering around here and really did not think we had any friends.

Thank you very much.

Senator KARNES. Well, I have been here 12 weeks and I find myself wandering around a little bit, too, looking for the committee hearing room. But I just want to say that I appreciate you coming to testify. I know all of you are very busy gentlemen, and that your time is very valuable. I sincerely appreciate you coming. I think the concepts that have been discussed today are very important.

I have been to a number of committee hearings and subcommittee hearings where there has only been one or two Senators. I think we should note that people like Senators Cochran, Boren, and Senator Lugar making a special effort to come here and actively participate in the hearing is an indication not only of the respect that they have for you, but also of the concern they have over this issue and the interest they have in finding a meaningful, viable legislative solution, proposing a legislative solution to this issue.

I want to thank you once again for coming, and, Mr. Ferguson, I may take you up on that offer to discuss that concept further. I think I will be trying to get a hold of the report on the Spokane Bank that I believe you mentioned, to see if that can provide myself, as well as some of my colleagues, additional insight into the scope of the problem and the genesis of the problems that we have today.

You can rest assured that all of us are here because we feel that this System is a very important System for agriculture, for production agriculture, for farming, and for agriculture as an industry in the United States. We are committed to make sure that this is a System that will continue not only as a viable entity, but as a System that will provide affordable and available credit to that very important segment of our American enterprise system, which is American agriculture.

Thank you again for coming. I appreciate your participation. We are adjourned.

[Whereupon, at 4:35 p.m., the subcommittee adjourned subject to the call of the Chair.]

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